

Materials for the Study of Banking

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PREFACE.

This book is frankly patterned after Professor Charles W. Gerstenberg's "Materials of Corporation Finance" and the syllabus and problems used with it. Here syllabus, materials, and problems are brought together in one book.

My experience in teaching banking has convinced me that the best approach is to consider present conditions and the history which has led up to them.

My obligations to others are many. From Professor J. Lawrence Laughlin, I received my training in banking history and theory. From Mr. Charles W. Dupuis, President of the Citizens National Bank, a colleague at the University of Cincinnati, I learned much about bank management and operation.

I have been fairly diligent in getting ideas and suggestions for problems from all of the standard treatises on banking. I have found the *Federal Reserve Bulletin* a veritable mine of information on banking topics.

I am indebted to Professor George W. Edwards for material on present conditions of banking in Europe. The American Acceptance Council, the General Motors Acceptance Corporation, and numerous banks throughout the country have kindly permitted me to reproduce material and forms.

J. D. M.

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CHAPTER I.

INTRODUCTION—FINANCIAL INSTITUTIONS.

Functions of financial institutions and the different classes performing each function :

I. Lending.

1. Consumption loans—proceeds used to get things for personal use, *e.g.*, food, clothes, doctor bills. These loans are handled by pawn shops, loan sharks, Morris plan banks, co-operative societies, ordinary banks (for the well-to-do), and merchants selling on credit.

2. Production loans—proceeds used in business.

(a) Commercial or short-time loans are handled by commercial banks, note brokers, companies that buy accounts or lend upon them, and dealers selling on credit.

(b) Investment or long-time loans take various forms :

(1) Stocks and bonds involve investment bankers, underwriters, stock exchanges, investment companies, and trust companies.

(2) Mortgages are made by savings banks, insurance companies, mortgage companies, building and loan associations, Federal farm loan banks, and joint-stock land banks.

(3) Notes in commercial banks and trust companies, renewed many times, are the basis of some investment loans.

II. Care and transfer of money.

1. Savings are handled by savings banks, savings departments of trust companies and commercial banks, building and loan associations, and postal savings banks.

2. Checking accounts are handled by commercial banks, trust companies, and private bankers.

3. Domestic and foreign exchange is handled by private

bankers, commercial banks, trust companies, and express companies.

III. Issue of notes.

In the United States, the issue of notes is restricted to the national banks and the Federal reserve banks.

IV. Keeping valuables.

Valuables are kept by safety deposit departments of commercial banks and trust companies, and by companies which specialize in the work.

V. Trustee functions.

These include such functions as acting as executor, administrator, trustee for mortgage, the care of real estate, registrar and transfer agent for stock, assignee, receiver, guardian, and curator. Such functions are undertaken by trust companies or trust departments of national banks.

Suggested Readings on Chapter I.

- ✓ Moulton, H. G.—Financial Organization, Chapter X.
- Willis, H. P., and Edwards, G. W.—Banking and Business, Chapter IV.
- Dewey, D. R., and Shugrue, M. J.—Banking and Credit, Chapter VIII.

Questions and Problems on Chapter I.

1. Are financial institutions becoming more or less specialized?
2. What are the advantages and disadvantages of specialization?
3. Give an example of each of the financial institutions mentioned.
4. Write the names of the various financial institutions in a column at the left of a sheet of paper and also at the right, thus:

Commercial banks
Savings banks
etc.

Commercial banks
Savings banks
etc.

Draw lines connecting each institution in the left-hand column with the institutions in the right-hand column with which it has dealings.

Which institution has the most lines?

Does the fact that this institution has the most lines indicate that it is the most important institution?

CHAPTER II.

GENERAL IDEA OF A COMMERCIAL BANK FROM ITS BALANCE SHEET.

The bank engages in many transactions which are common to all forms of business:

- Purchasing building and equipment.
- Raising capital.
- Paying running expenses.
- Making profits or suffering losses.
- Paying dividends.

In addition, the bank engages in many transactions which are more or less peculiar to its own business:

- Receiving deposits.
- Meeting checks drawn on the deposits.
- Loaning money.
- Discounting notes.
- Collecting checks.
- Cashing checks and drafts.
- Issuing circulating notes.
- Investing in securities.
- Dealing in exchange.

The balance sheet of a bank is a statement of its condition at the end of some business day. Since a bank is dealing in money and claims for money, it is a simpler matter for a bank to draw up a balance sheet than it is for a mercantile or manufacturing concern. In fact, the ordinary bank makes up a balance sheet each day.

The public is fairly familiar with the balance sheets of banks, as the Federal law and most of the State laws require their publication at intervals. The national banks must publish the statement five times a year.

Sometimes the statement does not represent the true condition of the bank. Assets are concealed:

1. To evade taxation when capital items are heavily assessed.
2. To discourage competition by concealing profits: insiders may defraud other stockholders.

Methods of concealing assets:

1. Don't list them.
2. Undervalue them.
3. Credit each shareholder's deposit.
4. Issue a certificate of deposit to some one as trustee for the stockholders.

Why liabilities are concealed:

1. To offset shortage in cash.
2. To cover wrongdoing of dishonest officials.

Materials on Chapter II.**Brief Explanation of the Principal Items in the Balance Sheet of a Bank.****Resources.**

Loans and discounts.—In the commercial banks, loans and discounts make up the bulk of the resources. They represent money advanced to business men for short periods. In the loan, the interest is paid after the time has elapsed. In the discount, the interest or discount is deducted in advance.

Overdrafts.—When depositors draw checks for amounts greater than their balances, the bank may pay the checks. If it does so, it has a resource in the amounts it will collect from its customers.

Customer's liability on account of acceptances.—When a bank agrees to accept a bill of exchange for a customer, it takes a liability (the bank must pay the bill when presented). To protect itself, the bank requires the customer to promise to pay the sum. Sometimes this promise is supported by collateral security.

United States Government bonds.—These bonds are a prime investment. In addition, the bonds may be deposited with the United States Treasury to secure national bank notes which the bank issues or to secure Government deposits.

United States certificates of indebtedness.—These are short-time obligations, and consequently make good investments for commercial banks.

Other bonds, securities, etc.—These may be purchased if the demand for commercial loans does not exhaust the funds of the bank. Frequently, banks buy the municipal bonds of the cities in which they are located.

Stock of the Federal reserve bank.—All national banks are required to subscribe to the stock of the Federal reserve bank in their district. Properly qualified State banks may subscribe.

Banking house.—The bank may own the building or buildings in which its business is carried on.

Furniture and fixtures.—The equipment utilized by the bank is an asset.

Exchanges for the clearing house.—Checks on other banks, when deposited in the bank, are collected if possible through the clearing house. Checks awaiting collection constitute claims on the other banks.

Checks on out-of-town banks.—These checks, which have been cashed or received as deposits, will be collected through the Federal reserve bank or through correspondents.

Lawful reserve with Federal reserve bank.—Banks have demand obligations in the form of deposits. The law forces the banks to keep on deposit in the Federal reserve banks a sum equal to a proportion of these deposits in order to protect the depositors. If the bank is short of cash, it may get cash from the Federal reserve bank.

Cash in vault.—This cash is held to meet depositors' claims. It may be the result of heavy deposits which shortly will be loaned or invested.

Other cash items.—These are items payable on demand, such as checks on other banks.

Due from banks.—In some of the more detailed statements, the amounts are divided as due from National and from State and private banks. These deposits in other banks arise in connection with the collection of out-of-town checks and the holding of balances in financial centers against which to sell exchange. The bank holding the balances is called the correspondent of the first bank.

Redemption fund with United States Treasury.—Each National bank issuing notes must keep deposited in lawful money in the Treasury of the United States 5 per cent of the amount of notes outstanding. Any unused portion of this fund is an asset of the bank.

Interest earned but not collected.—To be accurate, the bank computes the sums of interest on loans and investments which have accrued since the latest payment.

Liabilities.

Capital stock paid in.—The bank owes this sum to its stockholders. The capital stock acts as a guaranty fund to protect depositors, note-holders, and other creditors of the bank.

Surplus.—This fund performs the same function as capital. It is owed to the stockholders, because it has been built up out of earnings or from direct contributions. It carries no double liability as the stock usually does.

Undivided profits.—In this account are placed the earnings of the bank and from it are paid the expenses of the bank. It is owed to the stockholders. At intervals sums may be transferred from undivided profits to surplus. In many cases, the account reads, "undivided profits less expenses." At the end of some period, such as the month, the amounts expended are subtracted.

Individual deposits subject to check.—The bank owes its depositors the sums they have intrusted to it. The item is usually the largest liability of the bank.

Circulating notes outstanding.—Only National banks and Federal reserve banks can issue notes. A circulating note is the promise of a

bank to pay the bearer on demand, issued in an even amount. The bank owes the face value of the note to the holder of it.

Due to banks.—The correspondent banks mentioned above have deposits of banks. These show on the balance sheet as in this item.

United States deposits.—This item was formerly more important, as the Government used many banks as depositories. Now, most of the Government funds are kept in the Federal reserve bank.

Certified checks.—When a check is certified, the bank deducts the amount from the maker's balance and assumes the liability.

Cashier's checks outstanding.—These checks are orders for the bank to pay money signed by the cashier. They arise when the bank pays its bills. Until they are paid, they are liabilities of the bank.

Certificates of deposit.—These represent sums of money left with the bank, often for a definite period. Thus the bank owes the holders certain amounts.

Dividends unpaid.—When a bank declares a dividend, it owes the stockholders that amount.

Bills payable with the Federal reserve bank.—The bank borrows from the Federal reserve bank, and so becomes the latter's debtor.

Acceptances.—As was explained above, the bank assumes a liability to pay the acceptances, but has as an offsetting asset the customer's liability on the acceptances.

Discount collected but not earned.—This is simply a subdivision of undivided profits. It calls attention to the fact that the discount which is collected at the time the note is presented to the bank has not been really earned until the note becomes due.

The Effect of Bank Operations on the Balance Sheet of a Bank.

The balance sheet of a bank shows what the bank owes and what it has with which to pay. Mathematically, it is an equation. The equality is not disturbed if an equal amount is added to or subtracted from items on each side, or if the same amount is added to and subtracted from items on the same side.

In the following transactions, an increase in an item is indicated by the plus sign and a decrease by the minus sign. The resources are on the left side of the page and the liabilities on the right.

<i>Resources</i>		<i>Liabilities</i>
	<i>At the inauguration of the bank, the capital is paid in cash:</i>	
+ cash		+ capital

BALANCE SHEET

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The bank must have rooms and equipment:

+ real estate
+ furniture and fixtures
— cash

Customers deposit money:

+ cash + deposits

Customers withdraw money:

— cash — deposits

Customers deposit checks on other banks:

+ other cash items, or + deposits
+ due from other banks, or
+ exchanges for clearing
house, or
+ checks on other banks in
city

Customers deposit checks on bank itself:

+ deposits
— deposits

Customers deposit bank's own notes:

+ deposits
— bank notes outstanding

Bank cashes checks on other banks:

+ other cash items, or
+ due from other banks, or
+ exchanges for clearing
house, or
+ checks on other banks in
city
— cash

Bank discounts a note giving the proceeds in a deposit credit:

+ loans and discounts + deposits
+ undivided profits, or
+ discount collected but not
earned

Bank discounts a note giving proceeds in its bank notes:

+ loans and discounts + notes outstanding
+ undivided profits, or
+ discount collected but not
earned

MATERIALS OF BANKING

*Bank discounts a note
giving proceeds in
cash:*

+ loans and discounts	+ undivided profits, or
- cash	+ discount collected but not earned

*Customer pays off
discounted note
with cash:*

- loans and discounts
+ cash

*Customer pays off
discounted note
with check:*

- loans and discounts	- deposits
-----------------------	------------

*Bank grants loan
to customer in
cash:*

+ loans and discounts
- cash

*Bank grants loan
to customer
giving de-
posit credit:*

+ loans and discounts	+ deposits
-----------------------	------------

*Customer pays off
loan with cash:*

- loans and discounts	+ undivided profits
+ cash	

*Customer pays off
loan with check:*

- loans and discounts	- deposits
	+ undivided profits

*Bank buys bonds, etc.,
with cash:*

+ bonds, etc.
- cash

*Bank buys bonds, etc.,
with cashier's
check:*

+ bonds, etc.	+ cashier's checks outstanding
---------------	--------------------------------

*Bank sells bonds, etc.,
for cash at a loss:*

- bonds, etc.	- undivided profits
+ cash	

BALANCE SHEET

I I

	<i>Bank sells bonds, etc., for cash at a profit:</i>	
— bonds, etc.		+ undivided profits
+ cash		
	<i>Bank creates a surplus:</i>	
		+ surplus
		— undivided profits
	<i>Bank pays dividend in cash:</i>	
— cash		— undivided profits
	<i>Bank pays dividend by crediting stockholders' accounts:</i>	
		— undivided profits
		+ deposits
	<i>Bank spends money for salaries, etc.</i>	
— cash		undivided profits less + expenses

Suggested Readings on Chapter II.

- Moulton, H. G.—Financial Organization, Chapter XIX.
Agger, E. E.—Organized Banking, Chapter I.
Phillips, C. A.—Readings in Money and Banking, Chapter IX.
Kniffin, W. H.—The Practical Work of a Bank, Chapter
XIII.
Langston, L. H.—Practical Bank Operation.

Questions and Problems on Chapter II.

1. Make a balance sheet of a bank from the following:

Acceptances	\$ 412,394.66
Banking House	1,100,000.00
Capital	1,500,000.00
Cash on Hand, Deposit with Federal Reserve Bank and Due From Banks	6,318,482.81
Circulation	51,000.00
Clearing House Exchanges	1,337,887.70
Customers' Liability on Account of Acceptances	412,394.66
Deposits	32,031,858.44
Discounts and Loans	28,351,032.42
Dividend Payable	90,000.00
Federal Reserve Bank Stock	255,000.00
Interest Earned but not Collected	57,872.52
New York State Bonds	85,000.00
Other Bonds	50,000.00
Overdrafts	1,170.65
Reserves	592,958.35
Surplus	7,000,000.00
Undivided Profits	1,500,000.00
Unearned Discount	230,522.90
United States Securities	5,439,983.59

2. On the basis of the following make out a bank statement:

Acceptances	\$ 8,723,493.28
Bank Promises	3,836,478.78
Capital	5,000,000.00
Cash on Hand and in Federal Reserve Bank	20,920,581.84
Customers' Liabilities under Commercial Credits	8,176,611.31
Deposits	198,289,892.75
Due From Banks	7,955,943.46
Exchanges for Clearing House	56,036,426.85
Loans and Discounts	92,621,436.37
Other Cash Items	7,371,516.91
Other Securities	17,787,530.67
Reserved for Taxes	641,354.25
Surplus	12,500,000.00
Unearned Discount	414,381.92
United States Government Bonds	15,640,055.36

3. Arrange the following items as a balance sheet:

Banking House	\$ 25,000
Cash	27,818
Loans and Discounts	235,408
United States Bonds	41,000
Due to Banks	28,626
Circulating Notes	50,000
Due From Banks	37,188
Time Deposits	227,932

BALANCE SHEET

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Other Assets	24,318
Demand Deposits	56,660
Undivided Profits	2,514
Surplus	25,000
Capital	100,000

Draw up a new balance sheet after the following transactions have been completed:

- (a) Loan \$5,000 for 4 months at 6 per cent, giving one-fifth in cash and four-fifths in deposits.
- (b) Sell \$3,000 of other assets for \$4,000.
- (c) Pay a dividend of 5 per cent, one-half left on deposit and one-half withdrawn in cash.
- (d) Honor a check for \$550 for a customer whose balance is \$500.
- (e) Buy equipment for \$2,000, paying for it with a New York draft.
- (f) Receive deposits of \$12,000; \$4,800 in greenbacks, \$1,200 in bank's own notes, \$3,600 in checks on other banks; \$2,400 in checks on the bank itself.
- (g) Pay a bill of \$500 with a cashier's check.
- (h) Sell at a discount of 2 per cent, \$3,000 of four months paper bought from a note broker, and leave the proceeds on deposit with a correspondent bank.
- (i) Rediscount \$10,000 worth of eligible paper with the Federal reserve bank. The paper has 2 months to run; the reserve bank rate is 6 per cent. One-fifth of the proceeds is taken in Federal reserve notes and four-fifths are taken as a deposit credit.

4. A bank in a small town has the following balance sheet.

<i>Resources</i>		<i>Liabilities</i>	
Loans	\$400,000	Capital	\$ 30,000
Bonds	30,000	Surplus	20,000
Furniture and Fixtures	5,000	Undivided Profits	10,000
Due From Banks	15,000	Due From Banks	40,000
Cash	50,000	Deposits	400,000
	<hr/>		<hr/>
	\$500,000		\$500,000

A new cashier from the city wishes to give a more accurate statement and finds that discount collected but not earned is \$1,000 and that interest earned but not collected is \$500. Make out the new statement including the new items.

5. Two New York banks have the following condensed balance sheets. Which represents the greater protection to

depositors? Assume that the book values are correct and that the double liability of stockholders could be collected.

<i>Resources</i>	<i>Bank No. 1</i>	<i>Bank No. 2</i>
Loans and Discounts	\$5,000,000	\$5,000,000
Other Assets	1,000,000	500,000
Cash	500,000	500,000
	<hr/>	<hr/>
	\$6,500,000	\$6,000,000
 <i>Liabilities</i>		
Capital	\$ 125,000	\$ 500,000
Surplus	750,000	100,000
Undivided Profit	125,000	25,000
Notes, etc.	500,000	375,000
Deposits	5,000,000	5,000,000
	<hr/>	<hr/>
	\$6,500,000	\$6,000,000

6. Phillips, in Chapter II of his "Bank Credit," starts with the following bank account:

<i>Resources</i>		<i>Liabilities</i>	
Loans and Discounts	\$ 20,000	Capital	\$100,000
Overdrafts	10	Undivided Profits	300
Due From Banks	44,790	Deposits	94,500
Real Estate	5,000		<hr/>
United States Bonds	30,000		\$194,800
Cash	95,000		
	<hr/>		
	\$194,800		

The bank buys \$10,000 worth of notes from a commercial-paper house.

The notes run 4 months and are discounted at the rate of 6 per cent. New York and Chicago drafts are given in payment.

The bank loans a farmer \$5,000 in cash on a mortgage bearing 6 per cent interest payable yearly.

The bank discounts at 5 per cent a 30-day note for \$10,000, with stock-exchange collateral.

The bank buys \$65 worth of stationery and supplies.

The bank receives \$500 for a 4 per cent certificate of deposit.

A customer gets a Chicago draft for \$88.60. He pays for it in-cash, the bank charging him 10 cents exchange.

The bank buys \$112,000 worth of furniture and fixtures, paying for them with a cashier's check.

The bank takes \$25,000 of its Government bonds and deposits them with the comptroller of the currency to get bank

BALANCE SHEET

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notes. It keeps a 5 per cent redemption fund with the United States Treasury.

Phillips then declares that the condition of the bank is as follows:

<i>Reserves</i>		<i>Liabilities</i>	
Loans and Discounts.....	\$ 85,000.00	Capital	\$100,000.00
Overdrafts	10.00	Undivided Profits	\$841.77
Real Estate	5,000.00	Less Expenses ..	65.00 767.77
Furniture and Fixtures	12,000.00		
United States Bonds	30,000.00	Circulating Notes	25,000.00
Due From Banks	20,201.40	Deposits	104,458.33
Redemption Fund	1,250.00	Certificates of Deposit	500.00
Cash	89,273.70	Cashier's Checks	12,000.00
	<u>\$242,735.10</u>		<u>\$242,735.10</u>

Check the transactions. If your result does not agree with Phillips, endeavor to see what he has left out of the statement of transactions.

7. The following table gives the prices of five bank stocks in New York City in September, 1922:

<i>Name</i>	<i>Price about</i>	<i>To Yield about</i>	<i>Dividend Rate per Year</i>
Chase National Bank	344	5.81	20%
Irving National Bank	211	5.68	12%
National Bank of Commerce	281	5.69	16% ¹
National City Bank	333	6.00	20%
National Park Bank	452	5.31	24%

The statements of condition of the banks follow:

THE CHASE NATIONAL BANK.

Statement of Condition at the close of Business, September 15, 1922.

Resources

Cash, Clearing House Exchanges and Due from	
Federal Reserve Bank	\$135,443,713.62
Due from Banks	24,802,864.04
Demand Loans	72,581,598.92
	<u>\$232,828,176.58</u>
Bills Discounted	100,783,335.82
Time Loans	90,186,271.87
United States and other Bonds to secure Circulation and United States Deposits	5,700,760.00
United States Government Securities	34,827,991.03
Other Securities	18,670,025.19
Due from United States Treasurer	55,000.00
Customers' Liability account of Acceptances	15,409,677.94
	<u>\$498,461,238.43</u>

¹ Includes extra dividend.

Liabilities

Capital Stock	\$20,000,000.00	
Surplus	15,000,000.00	
Undivided Profits	6,787,280.92	\$41,787,280.92
<hr/>		
Reserved for Taxes, Interest, etc.		1,657,935.24
Dividend Payable October 2, 1922		800,000.00
Circulating Notes Outstanding		1,080,500.00
Deposits:		
Individuals	\$318,250,638.99	
Banks	112,280,468.82	
United States Government	3,576,350.00	434,107,457.81
<hr/>		
United States Government Securities Borrowed		3,200,000.00
Acceptances Outstanding		15,596,860.17
Other Liabilities		231,204.29
		<hr/>
		\$498,461,238.43

IRVING NATIONAL BANK.

Statement of Condition, September 15, 1922.

Resources

Cash in Vault and with Federal Reserve Bank...	\$29,043,855.97	
Exchanges for Clearing House and Due from other Banks	44,645,562.38	
Call Loans, Commercial Paper and Loans eligible for rediscount with Federal Reserve Bank...	85,337,542.67	\$159,026,961.02
<hr/>		
<i>Other Loans and Discounts:</i>		
Demand Loans	9,800,732.29	
Due within 30 days	11,293,719.45	
Due 30 to 90 days	27,217,083.75	
Due 90 to 180 days	33,974,212.12	
Due after 180 days	1,769,080.98	84,054,828.59
<hr/>		
United States Obligations		8,938,989.80
Short Term Securities		12,104,345.68
Other Investments		7,057,260.83
Bank Buildings		600,426.05
Customers' Liability for Acceptances by this Bank and its Corre- spondents [anticipated \$1,864,434.17]		15,593,720.97
		<hr/>
		\$287,376,532.94

Liabilities

Capital Stock	\$12,500,000.00	
Surplus and Undivided Profits	11,027,385.28	
Discount Collected but not Earned	1,033,781.08	
Reserved for Taxes and Expenses	851,425.34	
Circulating Notes	2,536,000.00	
Foreign Bills of Exchange sold with Indorsement of this Bank..	1,767,033.73	
Acceptances by this Bank and by Correspondents for its Account [after deducting \$93,765.60 held by the Bank]	17,458,155.14	
Deposits	240,202,752.37	
		<hr/>
		\$287,376,532.94

BALANCE SHEET

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NATIONAL BANK OF COMMERCE.

Statement of Condition, September 15, 1922.

<i>Resources</i>	
Loans and Discounts	\$225,452,494.70
Overdrafts, secured and unsecured	3,629.47
United States Securities	99,531,584.53
Other Bonds and Securities	7,037,857.54
Stock of Federal Reserve Bank	1,500,000.00
Banking House	4,000,000.00
Cash in Vault and Due from Federal Reserve Bank	58,472,902.14
Due from Banks and Bankers	5,575,645.55
Exchanges for Clearing House	59,220,192.68
Checks and other Cash Items	3,016,937.50
Interest Accrued	1,065,113.38
Customers' Liability under Letters of Credit and Acceptances	30,678,299.49
	\$495,554,656.98

<i>Liabilities</i>	
Capital Paid up	\$25,000,000.00
Surplus	25,000,000.00
Undivided Profits	12,778,559.58
Deposits	391,716,483.46
Dividends unpaid	12,556.50
Reserved for Interest, Taxes and Other Purposes	6,618,828.68
Letters of Credit	11,636,217.41
Acceptances executed for Customers	19,838,747.59
Acceptances sold with our indorsement	1,587,787.46
	\$495,554,656.98

THE NATIONAL CITY BANK OF NEW YORK AND DOMESTIC AND FOREIGN BRANCHES.

Condensed Statement of Condition as of September 15, 1922.

<i>Assets</i>	
Cash in Vault and in Federal Reserve Bank.....	\$93,454,351.24
Due from Banks, Bankers and United States Treasurer	96,282,607.38
	\$189,736,958.62
Loans, Discounts and Acceptances of Other Banks.....	488,869,663.95
United States Government and Other Bonds.....	\$88,560,851.08
Stock in Federal Reserve Bank	2,550,000.00
Ownership of International Banking Corporation.	8,500,000.00
	99,610,851.08
Bank Buildings	13,135,717.95
Customers' Liability Account of Acceptances	27,469,854.15
Other Assets	1,035,392.76
	Total
	\$819,858,438.51

MATERIALS OF BANKING

Liabilities

Capital	\$40,000,000.00	
Surplus and Undivided Profits	51,075,608.49	\$91,075,608.49
Deposits		644,139,429.81
Acceptances of Other Banks and Foreign Bills Sold with our Indorsement		32,665,616.15
Acceptances Outstanding as Per Contra	\$27,469,854.15	
Anticipated by Customers	787,283.12	28,257,137.27
Items in Transit with Branches		3,338,035.77
Circulation		1,898,195.00
Bonds Borrowed		1,958,000.00
Reserves for:		
Accrued Interest and Unearned Discount....	\$2,289,995.08	
Taxes and Accrued Expenses, et cetera	4,516,651.56	
Contingencies	9,719,769.38	16,526,416.02
Total		\$819,858,438.51

THE NATIONAL PARK BANK.

Statement of Condition at close of Business September 15, 1922.

Resources

Loans and Discounts	\$121,862,320.82
United States Bonds and Certificates of Indebtedness	20,352,365.33
Bonds to secure Postal Savings Deposits	2,869,000.00
Other Bonds and Stocks	8,644,165.56
Banking House	4,005,458.96
Due from Federal Reserve Bank	25,041,964.56
Exchanges for Clearing House	12,752,770.40
Cash and Due from Banks	3,356,909.03
Due from United States Treasurer	275,000.00
Customers' Liability Account of Acceptances and Letters of Credit	3,159,657.81
Interest earned but not collected	517,073.25
	\$202,836,685.72

Liabilities

Capital	\$10,000,000.00
Surplus and Undivided Profits	23,757,010.64
Discount Collected but not earned	979,585.48
Reserved for Taxes and Interest	942,972.08
Circulation	5,499,997.50
Acceptances, Foreign Bills and Letters of Credit	3,672,979.01
Deposits:	
Banks	67,379,500.58
Individuals	87,535,889.84
United States Government	3,068,750.59
	157,984,141.01
	\$202,836,685.72

(a) Figure the book value of the stock of each of the banks. How do you explain the differences between the book value and the market price?

(b) Explain why some of the stocks can be bought at prices which will yield more on the investment than others.

(c) What can you tell about the profitableness of the banks from their statements?

(d) If you were in a position to invest, which stock would you buy? Give your reasons.

8. What showing does the collateral held for loans make in the balance sheet of a bank?

9. How does bank surplus differ from capital? From undivided profits?

10. How does bank surplus differ from the surplus shown in the balance sheet of the ordinary corporation?

11. Why not have preferred stock in a bank?

12. Why do not banks issue bonds to get capital?

13. What items on the balance sheet of a bank are relatively permanent in amount?

14. What items on the two sides of the balance sheet of the bank keep a fairly definite relationship to each other? Why?

15. A bank has a capital of \$100,000, a surplus of \$50,000, and undivided profits of \$10,000. It pays dividends of 12 per cent a year. At about what price ought its shares to sell?

16. A national bank with a capital of \$100,000, surplus of \$100,000, and undivided profits of \$38,000 wishes to reduce the amount it can lend to one borrower. How can this be accomplished by a bookkeeping operation?

17. A bank with resources of \$4,500,000 wishes to go over \$5,000,000. How would its total resources and liabilities be affected if it borrowed \$500,000 from a correspondent; loaned \$600,000 of which \$400,000 was drawn on by checks which were deposited in other banks?

18. Indicate the changes in the balance sheet of a bank when it makes an allowance of \$1,000 for taxes accrued.

CHAPTER III.

NEGOTIABLE INSTRUMENTS.

Negotiable instruments need to be considered briefly because:

1. Bank's investments are mostly negotiable instruments.
2. Bank notes and checks by means of which most of our exchanging is done are negotiable instruments.

Form of a negotiable instrument.—A negotiable instrument must be in writing signed by the maker or drawer; must contain an unconditional order or promise to pay a sum certain in money; must be payable on demand or at a fixed or determinable future time; must be payable to order or to bearer. Where the instrument is addressed to a drawee, he must be named or otherwise indicated with reasonable certainty.

The development of the negotiable instrument law has come about through the desire to facilitate the use of these instruments in business. An innocent holder in due course may have a better title to the instrument than the person from whom he obtained it.

The defenses against liability are divided into two groups:

1. Personal or equitable defenses—good between the original parties but not available against a holder in due course.
2. Legal defenses—good against any holder.

Legal defenses.—Infancy, insanity, forgery, illegality (under a few statutes), and no intentional delivery of incomplete instruments as such.

Personal defenses.—Fraud, duress, illegality (under most statutes), no voluntary delivery, conditional delivery, and absence of consideration.

Materials on Chapter III.

Selections from the Negotiable Instruments Law.

§ 20. **Form of negotiable instrument.**—An instrument to be negotiable must conform to the following requirements:

1. It must be in writing and signed by the maker or drawer.
2. Must contain an unconditional promise or order to pay a sum certain in money.
3. Must be payable on demand, or at a fixed or determinable future time.
4. Must be payable to order or to bearer; and
5. Where the instrument is addressed to a drawee, he must be named or otherwise indicated therein with reasonable certainty.

§ 21. **Certainty as to sum; what constitutes.**—The sum payable is a sum certain within the meaning of this act, although it is to be paid:

1. With interest; or
2. By stated installments; or
3. By stated installments, with a provision that upon default in payment of any installment or of interest, the whole shall become due; or
4. With exchange, whether at a fixed rate or at the current rate; or
5. With costs of collection or an attorney's fee, in case payment shall not be made at maturity.

§ 22. **When promise is unconditional.**—An unqualified order or promise to pay is unconditional within the meaning of this act, though coupled with:

1. An indication of a particular fund out of which reimbursement is to be made, or a particular account to be debited with the amount; or
2. A statement of the transaction which gives rise to the instrument.

But an order or promises¹ to pay out of a particular fund is not unconditional.

§ 23. **Determinable future time; what constitutes.**—An instrument is payable at a determinable future time, within the meaning of this act, which is expressed to be payable:

1. At a fixed period after date or sight; or
2. On or before a fixed or determinable future time specified therein; or
3. On or at a fixed period after the occurrence of a specified event, which is certain to happen, though the time of happening be uncertain.

An instrument payable upon a contingency is not negotiable, and the happening of the event does not cure the defect.

¹ Error in engrossing.

§ 24. **Additional provisions not affecting negotiability.**—An instrument which contains an order or promise to do any act in addition to the payment of money is not negotiable. But the negotiable character of an instrument otherwise negotiable is not affected by a provision which:

1. Authorizes the sale of collateral securities in case the instrument be not paid at maturity; or
2. Authorizes a confession of judgment if the instrument be not paid at maturity; or
3. Waives the benefit of any law intended for the advantage or protection of the obligor; or
4. Gives the holder an election to require something to be done in lieu of payment of money.

But nothing in this section shall validate any provision or stipulation otherwise illegal.

§ 25. **Omissions; seal; particular money.**—The validity and negotiable character of an instrument are not affected by the fact that:

1. It is not dated; or
2. Does not specify the value given, or that any value has been given therefor; or
3. Does not specify the place where it is drawn or the place where it is payable; or
4. Bears a seal; or
5. Designates a particular kind of current money in which payment is to be made.

But nothing in this section shall alter or repeal any statute requiring in certain cases the nature of the consideration to be stated in the instrument.

§ 26. **When payable on demand.**—An instrument is payable on demand:

1. Where it is expressed to be payable on demand, or at sight, or on presentation; or
2. In which no time for payment is expressed.

Where an instrument is issued, accepted or indorsed when overdue, it is, as regards the person so issuing, accepting or indorsing it, payable on demand.

§ 27. **When payable to order.**—The instrument is payable to order where it is drawn payable to the order of a specified person or to him or his order. It may be drawn payable to the order of:

1. A payee who is not maker, drawer or drawee; or
2. The drawer or maker; or
3. The drawee; or

4. Two or more payees jointly; or
5. One or some of several payees; or
6. The holder of an office for the time being.

Where the instrument is payable to order the payee must be named or otherwise indicated therein with reasonable certainty.

§ 28. **When payable to bearer.**—The instrument is payable to bearer:

1. When it is expressed to be so payable; or
2. When it is payable to a person named therein or bearer; or
3. When it is payable to the order of a fictitious or non-existing person, and such fact was known to the person making it so payable; or
4. When the name of the payee does not purport to be the name of any person; or

5. When the only or last indorsement is an indorsement in blank.

§ 29. **Terms when sufficient.**—The instrument need not follow the language of this act, but any terms are sufficient which clearly indicate an intention to conform to the requirements hereof.

§ 30. **Date, presumption as to.**—Where the instrument or an acceptance or any indorsement thereon is dated, such date is deemed *prima facie* to be the true date of the making, drawing, acceptance or indorsement, as the case may be.

§ 31. **Ante-dated and post-dated.**—The instrument is not invalid for the reason only that it is ante-dated or post-dated, provided this is not done for an illegal or fraudulent purpose. The person to whom an instrument so dated is delivered acquires the title thereto as of the date of delivery.

§ 32. **When date may be inserted.**—Where an instrument expressed to be payable at a fixed period after date is issued undated, or where the acceptance of an instrument payable at a fixed period after sight is undated, any holder may insert therein the true date of issue or acceptance, and the instrument shall be payable accordingly. The insertion of a wrong date does not avoid the instrument in the hands of a subsequent holder in due course; but as to him, the date so inserted is to be regarded as the true date.

§ 33. **Blanks; when may be filled.**—Where the instrument is wanting in any material particular, the person in possession thereof has a *prima facie* authority to complete it by filling up the blanks therein. And a signature on a blank paper delivered by the person making the signature in order that the paper may be converted into a negotiable instrument operates as a *prima facie* authority to fill it up as such for any amount. In order, however, that any such instrument, when completed, may be enforced against any person who became a party thereto prior to

its completion, it must be filled up strictly in accordance with the authority given and within a reasonable time. But if any such instrument, after completion, is negotiated to a holder in due course, it is valid and effectual for all purposes in his hands, and he may enforce it as if it had been filled up strictly in accordance with the authority given and within a reasonable time.

§ 34. **Incomplete instrument not delivered.**—Where an incomplete instrument has not been delivered it will not, if completed and negotiated, without authority, be a valid contract in the hands of any holder, as against any person whose signature was placed thereon before delivery.

§ 35. **Delivery; when effectual; when presumed.**—Every contract on a negotiable instrument is incomplete and revocable until delivery of the instrument for the purpose of giving effect thereto. As between immediate parties, and as regards a remote party other than a holder in due course, the delivery, in order to be effectual, must be made either by or under the authority of the party making, drawing, accepting or indorsing, as the case may be; and in such case the delivery may be shown to have been conditional, or for a special purpose only, and not for the purpose of transferring the property in the instrument. But where the instrument is in the hands of a holder in due course, a valid delivery thereof by all parties prior to him so as to make them liable to him is conclusively presumed. And where the instrument is no longer in the possession of a party whose signature appears thereon, a valid and intentional delivery by him is presumed until the contrary is proved.

§ 36. **Construction where instrument is ambiguous.**—Where the language of the instrument is ambiguous, or there are omissions therein, the following rules of construction apply;

1. Where the sum payable is expressed in words and also in figures and there is a discrepancy between the two, the sum denoted by the words is the sum payable; but if the words are ambiguous or uncertain, references may be had to the figures to fix the amount;

2. Where the instrument provides for the payment of interest, without specifying the date from which interest is to run, the interest runs from the date of the instrument, and if the instrument is undated, from the issue thereof;

3. Where the instrument is not dated, it will be considered to be dated as of the time it was issued;

4. Where there is a conflict between the written and printed provisions of the instrument, the written provisions prevail;

5. Where the instrument is so ambiguous that there is doubt whether it is a bill or note, the holder may treat it as either at his election;

6. Where a signature is so placed upon the instrument that it is not clear in what capacity the person making the same intended to sign, he is to be deemed an indorser;

7. Where an instrument containing the words "I promise to pay" is signed by two or more persons, they are deemed to be jointly and severally liable thereon.

§ 37. **Liability of person signing in trade or assumed name.**—No person is liable on the instrument whose signature does not appear thereon, except as herein otherwise expressly provided. But one who signs in a trade or assumed name will be liable to the same extent as if he had signed in his own name.

§ 38. **Signature by agent; authority; how shown.**—The signature of any party may be made by a duly authorized agent. No particular form of appointment is necessary for this purpose; and the authority of the agent may be established as in other cases of agency.

§ 39. **Liability of person signing as agent, etc.**—Where the instrument contains or a person adds to his signature words indicating that he signs for or on behalf of a principal, or in a representative capacity, he is not liable on the instrument if he was duly authorized; but the mere addition of words describing him as an agent, or as filling a representative character, without disclosing his principal, does not exempt him from personal liability.

§ 40. **Signature by procuration; effect of.**—A signature by "procuration" operates as notice that the agent has but a limited authority to sign, and the principal is bound only in case the agent in so signing acted within the actual limits of his authority.

§ 41. **Effect of indorsement by infant or corporation.**—The indorsement or assignment of the instrument by a corporation or by an infant passes the property therein, notwithstanding that from want of capacity the corporation or infant may incur no liability thereon.

§ 42. **Forged signature; effect of.**—Where a signature is forged or made without authority of the person whose signature it purports to be, it is wholly inoperative, and no right to retain the instrument, or to give a discharge therefor, or to enforce payment thereof against any party thereto, can be acquired through or under such signature, unless the party against whom it is sought to enforce such right is precluded from setting up the forgery or want of authority.

§ 60. **What constitutes negotiation.**—An instrument is negotiated when it is transferred from one person to another in such manner as to constitute the transferee the holder thereof. If payable to bearer it is negotiated by delivery; if payable to order it is negotiated by the indorsement of the holder completed by delivery.

§ 61. **Indorsement; how made.**—The indorsement must be written on the instrument itself or upon a paper attached thereto. The signature of the indorser, without additional words, is a sufficient indorsement.

§ 62. **Indorsement must be of entire instrument.**—The indorsement must be an indorsement of the entire instrument. An indorsement, which purports to transfer to the indorsee a part only of the amount payable, or which purports to transfer the instrument to two or more indorsees severally, does not operate as a negotiation of the instrument. But where the instrument has been paid in part, it may be indorsed as to the residue.

§ 63. **Kinds of indorsement.**—An indorsement may be either special or in blank; and it may also be either restrictive or qualified, or conditional.

§ 64. **Special indorsement; indorsement in blank.**—A special indorsement specifies the person to whom, or to whose order the instrument is to be payable; and the indorsement of such indorsee is necessary to the further negotiation of the instrument. An indorsement in blank specifies no indorsee, and an instrument so indorsed is payable to bearer, and may be negotiated by delivery.

§ 65. **Blank indorsement; how changed to special indorsement.**—The holder may convert a blank indorsement into a special indorsement by writing over the signature of the indorser in blank any contract consistent with the character of the indorsement.

§ 66. **When indorsement restrictive.**—An indorsement is restrictive, which either:

1. Prohibits the further negotiation of the instrument; or
2. Constitutes the indorsee the agent of the indorser; or
3. Vests the title in the indorsee in trust for or to the use of some other person.

But the mere absence of words implying power to negotiate does not make an indorsement restrictive.

§ 67. **Effect of restrictive indorsement; rights of indorsee.**—A restrictive indorsement confers upon the indorsee the right:

1. To receive payment of the instrument;
2. To bring any action thereon that the indorser could bring;
3. To transfer his rights as such indorsee, where the form of the indorsement authorizes him to do so.

But all subsequent indorsees acquire only the title of the first indorsee under the restrictive indorsement.

§ 68. **Qualified indorsement.**—A qualified indorsement constitutes the indorser a mere assignor of the title to the instrument. It may be

made by adding to the indorser's signature the words "without recourse" or any words of similar import. Such an indorsement does not impair the negotiable character of the instrument.

§ 69. **Conditional indorsement.**—Where an indorsement is conditional, a party required to pay the instrument may disregard the condition and make payment to the indorsee or his transferee, whether the condition has been fulfilled or not. But any person to whom an instrument so indorsed is negotiated will hold the same, or the proceeds thereof, subject to the rights of the person indorsing conditionally.

§ 70. **Indorsement of instrument payable to bearer.**—Where an instrument, payable to bearer, is indorsed specially, it may nevertheless be further negotiated by delivery; but the person indorsing specially is liable as indorser to only such holders as make title through his indorsement.

§ 71. **Indorsement where payable to two or more persons.**—Where an instrument is payable to the order of two or more payees or indorsees who are not partners, all must indorse, unless the one indorsing has authority to indorse for the others.

§ 72. **Effect of instrument drawn or indorsed to a person as cashier.**—Where an instrument is drawn or indorsed to a person as "cashier" or other fiscal officer of a bank or corporation, it is deemed *prima facie* to be payable to the bank or corporation of which he is such officer; and may be negotiated by either the indorsement of the bank or corporation, or the indorsement of the officer.

§ 73. **Indorsement where name is misspelled, et cetera.**—Where the name of a payee or indorsee is wrongly designated or misspelled, he may indorse the instrument as therein described, adding, if he think fit, his proper signature.

§ 74. **Indorsement in representative capacity.**—Where any person is under obligation to indorse in a representative capacity, he may indorse in such terms as to negative personal liability.

§ 75. **Time of indorsement; presumption.**—Except where an indorsement bears date after the maturity of the instrument, every negotiation is deemed *prima facie* to have been effected before the instrument was overdue.

§ 76. **Place of indorsement; presumption.**—Except where the contrary appears every indorsement is presumed *prima facie* to have been made at the place where the instrument is dated.

§ 77. **Continuation of negotiable character.**—An instrument negotiable in its origin continues to be negotiable until it has been restrictively indorsed or discharged by payment or otherwise.

§ 78. **Striking out indorsement.**—The holder may at any time

strike out any indorsement which is not necessary to his title. The indorser whose indorsement is struck out, and all indorsers subsequent to him, are thereby relieved from liability on the instrument.

§ 79. **Transfer without indorsement; effect of.**—Where the holder of an instrument payable to his order transfers it for value without indorsing it, the transfer vests in the transferee such title as the transferor had therein, and the transferee acquires, in addition, the right to have the indorsement of the transferor. But for the purpose of determining whether the transferee is a holder in due course, the negotiation takes effect as of the time when the indorsement is actually made.

§ 80. **When prior party may negotiate instrument.**—Where an instrument is negotiated back to a prior party, such party may, subject to the provisions of this act, reissue and further negotiate the same. But he is not entitled to enforce payment thereof against any intervening party to whom he was personally liable.

§ 91. **What constitutes a holder in due course.**—A holder in due course is a holder who has taken the instrument under the following conditions:

1. That it is complete and regular upon its face;
2. That he became the holder of it before it was overdue, and without notice that it had been previously dishonored, if such were the fact;
3. That he took it in good faith and for value;
4. That at the time it was negotiated to him he had no notice of any infirmity in the instrument or defect in the title of the person negotiating it.

§ 94. **When title defective.**—The title of a person who negotiates an instrument is defective within the meaning of this act when he obtained the instrument, or any signature thereto, by fraud, duress, or force and fear, or other unlawful means, or for an illegal consideration, or when he negotiates it in breach of faith, or under such circumstances as amount to a fraud.

§ 95. **What constitutes notice of defect.**—To constitute notice of an infirmity in the instrument or defect in the title of the person negotiating the same, the person to whom it is negotiated must have had actual knowledge of the infirmity or defect, or knowledge of such facts that his action in taking the instrument amounted to bad faith.

§ 96. **Rights of holder in due course.**—A holder in due course holds the instrument free from any defect of title of prior parties and free from defenses available to prior parties among themselves, and may enforce payment of the instrument for the full amount thereof against all parties liable thereon.

§ 205. **Alteration of instrument; effect of.**—Where a negotiable

instrument is materially altered without the assent of all parties liable thereon, it is avoided, except as against a party who has himself made, authorized or assented to the alteration and subsequent indorsers. But when an instrument has been materially altered and is in the hands of a holder in due course, not a party to the alteration, he may enforce payment thereof according to its original tenor.

§ 206. **What constitutes a material alteration.**—Any alteration which changes:

1. The date;
2. The sum payable, either for principal or interest;
3. The time or place of payment;
4. The number or the relations of the parties;
5. The medium or currency in which payment is to be made;

Or which adds a place of payment where no place of payment is specified, or any other change or addition which alters the effect of the instrument in any respect, is a material alteration.

§ 210. **Bill of exchange defined.**—A bill of exchange is an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to order or to bearer.

§ 220. **Acceptance; how made, et cetera.**—The acceptance of a bill is the signification by the drawee of his assent to the order of the drawer. The acceptance must be in writing and signed by the drawee. It must not express that the drawee will perform his promise by any other means than the payment of money.

§ 260. **In what cases protest necessary.**—Where a foreign bill appearing on its face to be such is dishonored by non-acceptance, it must be duly protested for non-acceptance, and where such a bill which has not previously been dishonored by non-acceptance is dishonored by non-payment, it must be duly protested for non-payment. If it is not so protested, the drawer and indorsers are discharged. Where a bill does not appear on its face to be a foreign bill, protest thereof in case of dishonor is unnecessary.

§ 261. **Protest; how made.**—The protest must be annexed to the bill, or must contain a copy thereof, and must be under the hand and seal of the notary making it, and must specify:

1. The time and place of presentment;
2. The fact that presentment was made and the manner thereof;
3. The cause or reason for protesting the bill;
4. The demand made and the answer given, if any, or the fact that the drawee or acceptor could not be found.

§ 320. **Promissory note defined.**—A negotiable promissory note within the meaning of this act is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand or at a fixed or determinable future time a sum certain in money to order or to bearer. Where a note is drawn to the maker's own order, it is not complete until indorsed by him.

§ 321. **Check defined.**—A check is a bill of exchange drawn on a bank, payable on demand. Except as herein otherwise provided, the provisions of this act applicable to a bill of exchange payable on demand apply to a check.

§ 322. **Within what time a check must be presented.**—A check must be presented for payment within a reasonable time after its issue or the drawer will be discharged from liability thereon to the extent of the loss caused by the delay.

§ 323. **Certification of check; effect of.**—Where a check is certified by the bank on which it is drawn the certification¹ is equivalent to an acceptance.

§ 324. **Effect where the holder of check procures it to be certified.**—Where the holder of a check procures it to be accepted or certified the drawer and all indorsers are discharged from liability thereon.

§ 325. **When check operates as an assignment.**—A check of itself does not operate as an assignment of any part of the funds to the credit of the drawer with the bank, and the bank is not liable to the holder, unless and until it accepts or certifies the check.

§ 326. **Recovery of forged check.**—No bank shall be liable to a depositor for the payment by it of a forged or raised check, unless within one year after the return to the depositor of the voucher of such payment, such depositor shall notify the bank that the check so paid was forged or raised. (This section added by Laws of 1904, chap. 287.)

¹ The word "certification" substituted for "certificate" by Laws N. Y. 1898, c. 336.

Checks and Drafts.

N. 67

FOR COUNTER USE ONLY

STUB TO BE DETACHED AND
USED AS MEMORANDUM

191

TO MYSELF

\$

CONTINENTAL AND COMMERCIAL
NATIONAL BANK OF CHICAGO

COUNTER CHECK

THIS CHECK WILL BE PAID ONLY OVER
THE COUNTER OF THE CONTINENTAL AND
COMMERCIAL NATIONAL BANK OF CHICAGO
TO THE DRAWER IN PERSON.

CHICAGO, 19

Continental and Commercial National Bank of Chicago

PAY TO MYSELF ONLY \$

DOLLARS

NOT NEGOTIABLE

COUNTER CHECK WITH STUB.

No. _____ PHILADELPHIA _____ 19 _____

GIRARD TRUST COMPANY

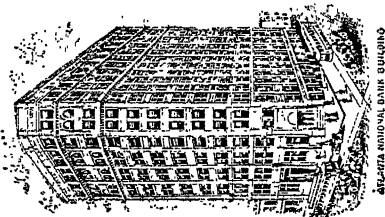
PAY TO THE
ORDER OF _____

_____ DOLLARS

\$ _____

H H H H H H

CUSTOMER'S CHECK.



ATLANTA NATIONAL BANK BUILDING

THE ATLANTA NATIONAL BANK

64-1

No. _____ ATLANTA, GA. _____ 19____

PAY TO THE ORDER OF

CUSTOMERS DRAFT \$ _____

VALUE RECEIVED AND CHARGE THE SAME TO ACCOUNT OF _____ DOLLARS

TO _____

Specimen

CUSTOMER'S DRAFT.

ESTABLISHED 1864.

THE PEOPLES NATIONAL BANK OF PITTSBURGH

PITTSBURGH, Pa. _____ No 49450

PAY TO
THE ORDER OF _____

CASHIER'S CHECK _____ DOLLARS

Specimen _____ CASHIER.

AMERICAN TRUST NOTE CO. NEW YORK

CASHIER'S CHECK.

Capital and Surplus \$30,000,000

Continental and Commercial National Bank

of Chicago

No. 419644

Chicago,

Pay to the order of

\$

Dollars

TO KOUNTZE BROTHERS, BANKERS 1-550
NEW YORK CITY

NEW YORK DRAFT.

PRO CASHIER

\$200 TRAVELERS CHEQUE FOR \$200

No. 000000

MELLON NATIONAL BANK
PITTSBURGH, PA. U.S.A.

Through its Correspondents
Will pay to the order of _____

\$200

IN THE UNITED STATES
TWO HUNDRED DOLLARS — \$200.00

WHEN COUNTERSIGNED WITH THE ABOVE SIGNATURE AND PRESENTED WITHIN ONE YEAR FROM DATE OF ISSUE
PITTSBURGH, PA.
COUNTERSIGN HERE

BANKERS BUYING RATE OF EXCHANGE
FOR CHECKS ON NEW YORK

Mellon National Bank of Pittsburgh

CASHIER.

TRAVELERS CHEQUE.

* Issued on Bank Note Company, New York.

Suggested Readings on Chapter III.

Huffcut, E. W.—Elements of Business Law.
Schaub, L. F., and Isaacs, N.—The Law in Business Problems.
Spencer, W. H.—Law and Business.
Moore, W. U.—The Law of Commercial Paper.

Questions and Problems on Chapter III.

1. *A* forges *B*'s name to a check. He does it so cleverly that the bank pays it. Who loses?
2. A carelessly drawn check is raised and the bank cashes it. Who loses?
3. A carefully drawn check is raised and the bank cashes it. Who loses?
4. Would the following be negotiable instruments?

New York, April 12, 1896.

Two months after the election of W. J. Bryan to the presidency of the United States, I promise to pay John Smith or order \$1,000.

RICHARD ROE.

New York, April 15, 1922.

At sight, pay to the order of John Doe, \$1,000 and reimburse yourself out of the reserve fund. Value received.

To Richard Roe, Treasurer.

JOHN BROWN, *Secretary*.

—— Broadway.

New York, April 15, 1922.

At sight, pay to the order of John Doe \$1,000 out of the reserve fund. Value received.

To Richard Roe, Treasurer.

JOHN BROWN, *Secretary*.

—— Broadway.

Peru, Ill., November 13, 1922.

Sixty days after date I promise to pay John Brown, or order, \$1,000 in New York exchange at a premium of \$1 a thousand.

BILL JONES.

Crete, Nebraska, July 4, 1921.

For value received, I promise to pay William Mann \$600, in monthly installments of \$50 with interest at 6 per cent payable monthly. If the installment or interest is not paid when due, the whole amount shall become due.

JOSEPH CHANCE.

5. Why are not oral promises to pay money negotiable?
6. Suppose that a man is an innocent holder for value of a stolen automobile. The original owner sues him. Who gets the car? Why?
7. Suppose a man is an innocent holder for value of a stolen Liberty bond. The original owner sues him. Who gets the bond? Why?
8. A man has a salary check for \$100. He owes the grocer \$20. He indorses the check, "pay to the order of William Smith \$20 of this check," and sends it to the grocer. What will happen?

9. John D. Smith gets a check made out, "John E. Smith." How shall he indorse it?

10. A superstitious woman possesses a check dated the 13th. She changes the date to the 18th. Can she collect the money?

11. Who can collect a check drawn: "Pay to Cash or Order"?

12. If the writing on a check says one hundred dollars and the figures indicate \$105, which governs?

13. If a crudely forged check is cashed by a bank, who loses?

14. A carpenter writes out an order on his bank on a pine board with a pencil. Is it negotiable?

15. John Smith promises to pay \$100 one month after his marriage. Is the instrument negotiable before his marriage? After his marriage?

16. Which of the following could you fill in on a check sent to you: date, place, amount, signature?

17. What is the purpose of protesting checks? Why is so much red tape necessary? Why are so many collection items sent with instructions not to protest?

CHAPTER IV.

CREDIT ANALYSIS.

Sources of Credit Information.

1. Borrower's Statement.
2. Dun and Bradstreet ratings. Special reports.
3. Bank's own records.
4. Those with whom borrower deals (buys from or sells to)
5. Trade associations.
6. Other banks.
7. General gossip of the community.
8. Interview with borrower.

Basis of Credit.

Facts as to ability and willingness to pay.

1. Honesty.
2. Personal qualities, church, gambling, lodges, extravagance of self or wife, political ambitions.
3. Business ability—experience in line of business and other lines, age.

Facts as to business.

1. Ratio of quicks.
2. Capital owned.
3. Location and character of competition.

Interpreting the Statement.

1. Primarily interested in ratio of the quicks.
2. Secondarily interested in the net worth in case of liquidation.
3. Good net profits, really earned, show a favorable condition.

Benefit of Borrower's Statement to Borrowers.

1. Slows down the too optimistic.
2. Banker may give helpful advice.
3. Forces better accounting system.

Reasons for Refusal of Statement.

1. Fear of not making a good showing.
2. Fear that too prosperous showing would invite competition.
3. Conservatism.

Sins Against Credit.

1. Kiting.
2. Overdue paper.
3. Overdrawing.
4. Drawing against uncollected funds.

Reasons for the Growth of the Credit Departments of Banks.

1. Banks deal in commercial paper for themselves or their customers.
2. Business becomes too big for it to be possible to know each borrower intimately and remember all the data about loans.
3. Spread of corporations eliminates much of the personal element.
4. New and better sources of credit information now exist.
5. Statements for paper rediscounted with Federal reserve banks now required.

Contents of Folder in Credit Files of a Bank.

1. Comparative summary statements.
2. General information—memoranda of conversation of officers; information secured by investigation.
3. Agency reports—Dun, Bradstreet's, etc.
4. Circulars of bond houses concerning security issues of the concern; copies of bond indentures, etc.
5. Clippings—new items about the concern.
6. Inquiries—copies of letters written by the bank to inquirers about the condition of the concern.

Credit Information from Mercantile Agencies.

1. Information not always up-to-date.
2. Much is on basis of borrower's own statements.
3. Gives valuable facts about age, fires, litigation, failures, etc.

Credit Information by Interview.

Judge face and character. Find out indirectly borrower's notion of honesty. Get an account of his start in life. If he made his own money, he will be more careful.

Credit Information from Banks.

Replies about fellow townsmen may show bad judgment or intentional misrepresentation, especially if the local banks have some of the man's paper.

Credit Information from the Trade.

From checks and drafts it is possible to get names of firms with which the borrower deals and to find out how accounts are taken care of. If he deals with first-class houses his credit is probably good. Find out if they sell to him largely, whether he is making money, and whether the moral hazard is good.

Materials on Chapter IV.

Analysis of Borrowers' Statements.

Customary terms of sale should show accounts or notes receivable and proportion of each to total sales.

At most liquid season, ratio of quick assets to current liabilities should be as two to one.

- ✓ A manufacturer's sales should be from one to three times capital.
- ✓ Jobbing sales should be from four to five times capital.
- ✓ Raw products or brokerage sales should be five to twenty times capital.

Borrower's Statement (Assets).

Cash.—Cash should be from five to fifteen per cent of the quick assets. Are there any I. O. U.'s or worthless checks? Is the cash in failed banks? Any stolen by employees? Any liens against it? Is it a special deposit? Will it be paid out next day in dividends? Has showing been made by postponing expenditures and accumulating receipts?

Accounts and notes receivable.—If it is not trade custom to use notes, they probably represent slow accounts. Allowance should be made for bad debts. Watch out for personal accounts of officers and employees. A wide distribution means less chance of bad collection from local depression. Are any accounts and notes receivable in the hands of an attorney for collection? Have any been assigned or sold to discount companies? Are any due from branches or affiliated concerns? Have any notes been renewed? Are any past due?

Merchandise or inventory.—This item should be valued at cost or market value, whichever is lower. Is any of the merchandise old, shop-worn, or out of style? Goods scattered in various branches are harder to handle. Are second-hand goods placed at their trade-in value? It is not fair to omit merchandise and the bills for it, which show small stocks and reduced liabilities. Raw materials and supplies may be appraised at cost, as may also finished goods with a ready market. Partly finished goods in case of failure require heavy expenditures under unfavorable conditions, to realize anything.

Real Estate, machinery, and equipment.—A full description showing in whose name these are held is essential. Is there any indebtedness? Are there any liens, back taxes, or unused real estate of little value? Such items do not constitute a quick asset. If specialized, the plant might have little value in liquidation because it would need to be remodeled. Buildings used for merchandising can be easily used for other things. Machinery in liquidation is not worth much except for scrap. Make sure that provision has been made for repairs, renewals, and replacement.

Stocks and bonds.—Stocks and bonds, if listed, are quick assets. If they are subsidiary companies, they may be a contingent liability. They may also indicate that the firm has been speculating.

Trade-marks, patents, good will, etc.—Often even those which have value in a going concern have little value in liquidation. Organization expenses should be written off early. Taxes or insurance paid in advance are no value in liquidation.

Bills payable to own banks.—It is well to know the maximum amount borrowed during the past year, as the statement may have been made at a time when least was borrowed.

Borrower's Statement (Liabilities).

Bills payable for merchandise.—These should be small. If they are not, there is an indication of failure to take discounts because of carelessness, overtrading, or backward collections. There should be a record, even if bills have not been presented. Paper sold to note brokers should be included. *It is not good practice to offset accounts payable by accounts receivable and show only the balance: the liabilities are sure and the assets are not.

Bonded debt.—It is well to know the redemption date and amount of interest accrued. Early maturity or unfulfilled provisions about interest or sinking fund may cause trouble. If the mortgage covers equipment, merchandise, and cash, not much would be left for the bank in case of liquidation.

Deposits of money.—Money deposited by families of members of the firm or by employees would probably be withdrawn ahead of any disaster.

Other liabilities.—Contingent liabilities for indorsed and discounted notes are counted by some very conservative people as current liabilities. Accrued liabilities are for wages, taxes, rent, and interest payable. If not shown in the statement, books are not accurately kept.

Capital and surplus, proprietorship interest, or net worth.—Enough capital is needed to support the volume of business; corporate surplus is often fictitious. In the case of individuals or partnerships, a small net worth may be offset by outside resources of the borrower.

The Income Account.

This shows the trend of the business, and may throw light on items in the balance sheet. Capitalization of repairs and maintenance pads profits and the permanent assets account.

The expense account.—The expense account should be compared with those of other firms in the same line of business. Adequate insurance should be carried to cover the credit risk. Big salaries may weaken a business and indicate high living. It is necessary to see that proper depreciation has been charged. A conservative plan is to charge betterments and extensions to operating accounts.

Net profits.—Beware of unbroken symmetrical gain. Ascertain whether profits are based on contracts which will not be renewed.

Terms of Sale.

From Federal Reserve Bulletin, Vol. 6, pp. 797-813 (Aug., 1920).

The following is the fifth of a series of articles giving data as to current practice and recent history of terms of sale in the principal industries. Acknowledgment is due the many business houses, individuals, trade periodicals, and trade associations who have courteously furnished the information.

Wholesale Dry Goods.

Dry goods jobbing is exceedingly complex. Many different classes of goods are handled, and the business of individual jobbers differs somewhat. Houses are of several types.¹ First are the large nation-wide general dry goods jobbers, located in the larger markets, in particular in Chicago and St. Louis in the Mississippi Valley, who cater to buyers throughout the entire country. Larger stocks are carried, with greater range in quality and selection, and the volume of business done enables each to conduct practically a specialty business in each department, while a large mill shipment business is also done, shipments being direct from mill to retailer. Second are local general jobbers, located in important railroad centers, and covering a more limited territory, being found in the upper Mississippi Valley, the central South, and on the Pacific coast, though rarely in the territory accessible to New York. Third are smaller local jobbers, covering a more restricted territory, and found to a considerable extent in the South. The differences between the three types are largely in the extent of territory covered. In the second and third, however, certain differences may also appear according to the territory in which the house is located, and a corresponding difference in the character of goods handled. Thus heavier goods, such as blankets, flannels, and woolen underwear, play a larger rôle in the

¹ This classification is substantially similar to that of Cherington, *The Wool Industry*, pp. 142 ff.

North and Northwest, and these items carry a later dating than do the regular items. Likewise, it has been suggested that eastern houses have a larger percentage of their business in finer and more expensive goods in which the style factor plays a larger rôle than is the case in other sections of the country. Most eastern jobbers cover limited territories, and their customers are in close proximity to the market, so that most of their buying is done in the market and from open stock, whereas in the West sales for future delivery play a larger rôle.

In order to clarify the discussion the various items which are handled may be classified as follows: Piece goods, notions, white goods and linens, ladies' ready to wear, men's furnishings, hosiery and underwear, and floor coverings. Of each of these there may be several subdivisions. Leading houses will have departments organized along these or other general lines, although the plan of departmentalization may vary greatly from house to house, and the notion department in certain houses, for example, may include many other items such as jewelry, laces, and embroideries, veilings, dress trimmings, buttons, umbrellas, etc., as well as those recognized as regular notion items. Following are the classifications of departments in two leading houses:

- | | |
|---|---|
| 1. Domestics. | 1. Domestics. |
| 2. Dress goods. | 2. Woolen goods, including blankets and flannels. |
| 3. Silks and velvets. | 3. Short length cotton piece goods. |
| 4. Upholstery. | 4. Curtains and draperies. |
| 5. Cabinet hardware. | 5. Dress goods. |
| 6. Blankets, flannels, linings. | 6. Silks. |
| 7. Furs. | 7. Wash goods. |
| 8. Cloaks, suits, waists. | 8. Prints, ginghams, and percales. |
| 9. Muslin underwear. | 9. Linings. |
| 10. Knit underwear. | 10. Linens, damasks, laces, and embroideries. |
| 11. Hosiery. | 11. Ribbons, notions, etc. |
| 12. Gloves. | 12. Underwear, sweaters, gloves, ties. |
| 13. Linens. | 13. Hosiery. |
| 14. White goods. | 14. Ladies' ready to wear. |
| 15. Notions and trimmings. | 15. Shirts. |
| 16. Umbrellas and ribbons. | 16. Overalls, pants, and duck clothing. |
| 17. Yarns, thread, and knit goods. | |
| 18. Rugs, carpets, and oilcloths. | |
| 19. Furniture. | |
| 20. Laces, embroideries, and lace curtains. | |

For the present purpose, another significant classification which should be noted is that into staple and fancy items, cotton piece goods, thus for example, being of both descriptions. It may be remarked, however, that the volume of piece goods handled has decreased greatly over a period of years. In addition to the regular distributors mentioned

above, during the past two years, "loft" or "secondary" distributors have grown up who find an outlet for their merchandise through the channels of regular jobbers and also to manufacturers of garments who could not secure sufficient quantities of merchandise through the regular mill channels.

As in other leading jobbing lines, great interest has been displayed in the terms upon which merchandise is purchased, and both of the leading associations have considered the matter, though from somewhat different points of view. The National Wholesale Dry Goods Association has considered primarily the adequacy of the cash discount or cash premium allowed on separate articles. Its several divisions, in particular the Jobbers Association of Notion Buyers, have regularly communicated in the past with manufacturers whose discounts, both cash and trade, were unsatisfactory, or who announced a decrease in or elimination of the same. The Southern Wholesale Dry Goods Association has considered, rather, the question of a uniform set of terms to apply to all purchases. The committee appointed to deal with the matter, which existed for several years, recommended uniform terms of 2 per cent 10 days, 60 days extra, instead of the variety of terms actually in use. In 1919 the report of the steering committee to deal with factors, commission merchants, and manufacturers, and appointed for the purpose of improving relations between the two groups, again recommended, among other things, "a minimum cash discount of 2 per cent, with minimum dating of 60 days on all commodities." Since the opening of the war period the problem has assumed new importance as a result of the curtailment of terms and decrease of discounts by houses selling the jobber. Thus, it is stated that 10-day terms have frequently been quoted or, where 60 days was still given, such high rate of anticipation attached as practically to force payment within 10 days. Coupled with this has been the demand that the wholesaler take goods far in advance of the season for immediate payment. While this has been due in part to the efforts of purchasers to obtain advance deliveries for fear of later shortage, it has been pointed out that the effect has been to force wholesalers in many cases to finance several seasons' goods at the same time, thus financing two-thirds of their business in two months' time. The situation has been aggravated by the billing of goods by mills prior to delivery to the transportation company, in the event of embargoes or refusal of the carrier to receive the goods. He himself has found it necessary to continue to carry the retailer, and his regular terms on the whole have shown relatively little change. "Summed up briefly," then, it has been stated that "the wholesale dry goods house is to-day bearing both the burdens of the manufacturer and of the retailer."

The Southern Wholesale Dry Goods Association alone has taken formal action in adopting a set of maximum terms upon which it is recommended that goods be sold. After discussion at each of its previous conventions, in 1915 terms were adopted at Nashville of 2 per cent 10 days, net 30 days, on season shipments, with dating of October 1st and April 1st for shipments after June 1st and January 1st, respectively. Intermediate shipments carried 60 days extra, terms on them being 2 per cent 10 days, 60 days extra, net 90 days. In 1916 and 1917 these terms were reaffirmed, and in the latter year an interpretation was added, stating that June to July and January to February shipments carried the season datings, while shipments during August to December and during March to June carried the terms for intermediate shipments. At these conventions the members practically universally expressed satisfaction with the terms, and in a considerable number of cases favored the adoption of even shorter terms. It has been stated that more than 90 per cent of the membership were making terms less than the maximum outlined in the Nashville resolution. Thus, instances of the omission of net 30 days on season terms were reported, as well as the use of 2 per cent 10 days, 30 days extra. In 1917 some houses had eliminated the 10 days on season shipments, making terms October 1st and April 1st with 2 per cent discount, as well as on intermediate shipments, 2 per cent 60 days thus being given. Several instances of longer terms were reported, such as 2 per cent 10 days, net 60 days, on shipments bearing season dating, as well as 3 per cent 10 days October 1st. Some houses, in particular in Tennessee and at New Orleans, reported difficulty in enforcing the terms, due to competitive conditions.

The feeling in favor of shorter terms resulted in a revision of the terms in 1918 at the New Orleans convention. The 10 days on season shipments were omitted, making terms on season bills 2 per cent October 1st and April 1st, and due net November 1st and May 1st. Intermediate shipments carried terms of 2 per cent 10 days net 60 days but exception was made of department stores, which were to be granted 60 days extra on such shipments. The latter concession, which was intended to be used merely where competition forced the naming of such terms, however, seemed to have been "misunderstood, misinterpreted, and generally has caused confusion and dissatisfaction," to quote the report of the committee on terms at the 1919 convention. Accordingly the committee, while recommending the same season terms, favored 2 per cent 60 days on intermediate shipments, but strongly recommended that bale goods and all intermediate shipments of other goods as far as possible be billed on terms of 2 per cent 10 days, net 60 days. The longer terms on intermediate shipments were specified in view of the fact that

certain of the members had previously employed them, and they also were felt to be necessary to enable those coming in contact with the larger markets to meet these terms. An unsuccessful effort was made by certain members so situated to reinstate the 10 days which the New Orleans terms had withdrawn. It is understood that there has been no subsequent change in the formal terms.

The several territorial divisions of the association have also interested themselves in the subject and have passed resolutions indorsing the recommended terms, as well as made recommendations to the association's committee on terms. In 1919 a large majority of eastern Tennessee houses were reported to have terms of 2 per cent 30 days, net 60 days, and on sales to department stores 2 per cent 60 days, net 90 days. West Virginia houses, which had first adopted terms of 30 days extra, 2 per cent 10 days, net 60 days, in consequence of subsequent adoption of 2 per cent 10 days, 60 days extra, net 90 days, by outside jobbers, recommend the adoption of such terms. Terms have also been adopted locally in certain cases, Cincinnati houses, through their association in 1918, adopting terms similar to those of the Southern Dry Goods Association.

The matter of terms of sale has been discussed at many of the conventions of the National Wholesale Dry Goods Association. Complaint has been made at various times of the tendency of purchasers to deduct discounts when running somewhat beyond the discount period, as well as to endeavor to deduct discounts and add interest instead when taking longer time, such as, for example, with terms of four months or with note settlements. In 1913 it was suggested by several members that formal action be taken, but nothing was done. In 1914 the necessity of curtailing season datings in order to afford an increased margin of profit was emphasized. The old datings were largely continued by jobbers, although they had been eliminated by manufacturers. Jobbers' cash discounts were stated not to differ much from manufacturers' although some jobbers had eliminated the old regular terms and employed net terms instead. With the pronounced shortening of terms by manufacturers during the war, increased stress was placed upon the necessity of a corresponding shortening in jobbers' terms. Additional emphasis was lent by the steadily rising cost of doing business. The adjustment of terms on each line exactly to correspond with manufacturers is not, however, possible in all cases, inasmuch as jobbers' terms are in many cases the same for all kinds of a general type of goods. At the 1918 meeting various houses cited instances of shortening of terms, such as moving the season dating forward one month from May 1st and November 1st to April and October 1st, elimination of 60 days extra, and of 10

days' time on season terms, and use of net 10 days in place of 2 per cent 10 days.

General agreement, however, existed as to the undesirability of concerted action, and this was reiterated at the meeting held in July, 1918, the "consensus of opinion being that a nation-wide uniform set of terms would not be possible for all sellers of dry goods, underwear, hosiery, notions, and kindred goods." At the meeting earlier in the year, the secretary had been instructed to collect the terms of members, which was done. While great variety appeared, the compilation showed a decrease in the time given and a tendency to closer terms. It was stated to be "a proven fact that the 'terms situation' was in better shape than at any previous period," and that "the improvement might reasonably be expected to continue." While there was an effort at further shortening, terms at present, however, are stated to be substantially on the same basis as indicated in the survey.

We may proceed to examine in greater detail the terms of the 135 houses which are given in this survey. The general terms are 2 per cent 10 days, 60 days extra, for many years recognized as the regular dry goods terms. While in many cases no terms beyond the 70-day period are formally quoted, and bills are due net after 70 days, in other cases net 90 days or net 4 months is frequently specified, though there has been a tendency toward the first-named net terms. Anticipation at the rate of 6 per cent per annum is generally permitted, which gives a cash discount of 3 per cent 10 days, which, in fact, is quoted by some houses, as well as in some cases, 1 per cent 10 days, net 30 days. Season datings most frequently specified are April 1st and October 1st, in general for shipments made prior to two months before the dating, thus being February 1st and August 1st for the datings given, after which time the regular 60 days' extra terms are given. Certain houses, however, employ other season datings, in particular May 1st and November 1st, for the general line, while several instances of earlier datings, such as February 1st and March 1st and August 1st and September 1st, were also noted. Orders bearing the season dating in general carry no further dating, although in certain cases 60 days extra was also given, mainly by houses having the earlier season datings and practically nullifying the same. In all sections houses are found which do not employ the regular terms or which have no season datings. In part this is the result of a shortening of terms in recent years, and one house states that there has been a decided tendency to eliminate season datings during the last two years, while in part it is a reflection of the character of business done. Some houses noted that they had recently revised their terms, while others either were contemplating or favored revision. Thus,

in some cases, 30 days extra in place of 60 days was given to new accounts, and in St. Louis several leading houses had eliminated the 10 days of grace on season datings, bills then being subject to 2 per cent discount for payment on October 1st, while in certain cases, for example, in Los Angeles, houses had eliminated these 10 days in connection with the regular terms. Some houses then sold on terms of 2 per cent 10 days or 2 per cent 30 days net 60 days, while terms of 2 per cent 10 days, 1 per cent 30 days net 60 days, were also found, and an effort was being made in northern New York to obtain the adoption of such terms by jobbers. Jobbers handling primarily special lines such as hosiery and underwear, or men's furnishings, also depart in some cases from the regular terms, following the manufacturer's terms on these items, which will be indicated below. Certain markets, such as St. Louis and Baltimore, have been known in the past for their liberality in the matter of terms, but the former has advanced the customary dating from May 1st and November 1st to April 1st and October 1st during the last few years. Jobbers located at smaller centers in various sections in a number of cases instance the competition of a larger neighboring market as forcing the granting of 60 days extra, a November 1st season dating, etc.

The extent to which houses classify their business and extend different terms on each class would appear to vary roughly to some extent with the size of the market. Houses located in the smaller centers in many cases have but one set of terms to apply to their entire business. In the larger markets, in particular those of the Middle West, distinction in general is made between spring goods and fall goods, certain of which in each case bear a dating one month later, factory or manufactured goods produced by the house itself, and mill shipments, while staples in certain cases are also distinguished. In between these two extremes there is wide variety, many houses having a lesser number of types, and in certain sections, such as in the East, the entire range of types is frequently not found. Classification presents a twofold aspect, certain goods having both different discounts and net terms, while with others the difference is merely in the season dating. Mill shipments in general bear terms of net 30 days, although some houses give net 60 days or net 60 days on certain items only, such as towels and white goods, while giving net 30 days on other items. Little uniformity appears in the terms on overalls, work shirts, and similar items, instances noted being net 30 days or 60 days, in some cases with a discount of 1 per cent 10 days, 2 per cent 10 days, and 2 per cent 10 days 60 days extra, but no season dating in general is given on these lines. Terms on yarns, spool cotton, and thread also vary somewhat, instances of 1 per cent and 2

per cent 10 days net 30 days and 60 days being reported, without season dating. Terms on floor coverings are as a rule 4 per cent 10 days, 60 days extra.

In part, classification results from an effort to shorten terms or reduce discounts to correspond to manufacturers' changes in terms with respect to certain items. Thus, certain houses give no season dating on some items like prints, domestics, percales, gingham, and sheetings; in some cases only on specified brands. Some houses, in addition, have eliminated the cash discount, and bill these and similar items on terms of net 60 days, while others have advanced the season dating one month, from April 1st and October 1st to March 1st and September 1st. This tendency is also seen in connection with certain items such as hosiery and knit underwear, which, while frequently continuing to bear a season dating, in the case of many other houses are sold without such dating, or bear merely terms such as net 10 days or 1 per cent 10 days, 30 days or 60 days extra, similar discounts being applied also by certain houses in connection with the season dating. Certain items, however, frequently carry the later season datings of May 1st and November 1st. Among these may be noted laces and embroideries, white goods, cloaks, and furs (which in some cases carry December 1st dating), blankets, underwear (when a dating is given), sweater coats, and fancy knit goods. These items are of a twofold character, being either heavier goods, which will be wanted for later fall use, or style items. Some eastern houses report a later shipment date in lieu of season datings, while some houses extend additional time on shipments to more distant territories, one house, for example, extending one month's extra dating on its Montana business.

Collections naturally vary with the different seasons of the year, payments being concentrated largely in the spring and fall. As fall sales are heavier than spring sales, they are heavier in the fall, this being noted alike for each of the various parts of the country. In certain agricultural sections, such as the Dakotas and Montana, this will be accentuated by the fact that accounts are carried to some extent until the fall, and certain houses selling such sections report a larger proportion of accounts in the summer which do not take the discount. The movement of merchandise with the majority of wholesale dry goods houses is about 40 per cent in the first six months of the year and 60 per cent in the last six months.

The following figures show the proportion of their total annual receipts received by three houses during each month of the year. It should be noted, however, that the data are not strictly comparable, inasmuch as the terms of the houses differ somewhat:

	Jan.	Feb.	Mar.	Apr.	May	June
New England ¹	7.0	5.6	6.5	7.4	8.3	8.3
Northwest	5.6	5.0	5.4	7.0	7.0	5.7
North Pacific coast	6.0	6.1	5.1	6.1	6.6	6.6

	July	Aug.	Sept.	Oct.	Nov.	Dec.
New England ¹	7.7	7.5	8.4	9.5	11.5	12.3
Northwest	6.6	7.0	8.7	12.0	18.0	12.0
North Pacific coast	7.8	7.9	10.8	13.8	11.8	11.5

A leading authority states that on an average about 50 per cent of the accounts of retailers with wholesalers are discounted, and about 20 per cent are anticipated at the usual anticipation rate of 6 per cent, dependent upon locality and trade conditions. Several New England houses report that from 25 to 30 per cent of the number of accounts anticipate, 60 to 65 per cent pay at the due date (i. e., in 70 days), and 10 per cent run beyond. Several northwestern houses agree that 40 to 45 per cent of their accounts discount, and one states that 30 per cent pay at maturity, while the balance require more or less banking accommodation. One southwestern house has 66.75 per cent of its accounts anticipated and discounted, and 33.25 per cent paid at the net period, while another has 10 per cent of its accounts paid in 10 days, 40 per cent in up to 30 days, and 20 per cent in 31 to 60 days, and the balance in 61 days to 4 months.

Interest has been displayed in the trade acceptance by both trade associations. The national association has sent out considerable descriptive literature, while the 1918 convention of the southern association adopted a resolution favoring it, and several members who were employing it reported themselves well pleased with it. At the 1919 convention 20 members present at one of the meetings stated that they used acceptances. On the whole, however, as in other jobbing lines, the instrument is not used by the majority of houses.

Men's Wear Woolen and Worsted Jobbing.

As is the case with goods for women's wear, woolens and worsteds for men's wear find their way into consumption via one of two channels, the jobber who sells to the small tailor and the ready-made clothing manufacturer. The latter industry developed earlier than did the women's ready-made industry, which consequently has drawn most of its forms and methods of operations from it, and a greater portion of

¹ Another New England house also notes that payments drag from about Jan. 15 to Mar. 15 and from July 1 to Sept. 1.

men's clothing is factory made. In 1900 the output of men's clothing as a factory product was already valued at twice the custom product. The number of factory-made garments would be even greater, inasmuch as the relatively higher priced garments are made by the tailor.

The jobbers of men's wear woolens and worsteds and tailors' trimmings are of two principal kinds. Due to the scarcity existing in the cloth markets during the last few years, and the great number of resales, the class of traders existing alongside of the so-called "old-line" jobber has assumed particular importance in this branch of the textile industry also. The principal markets in which trading occurs are New York, which is by far the largest, Boston, Philadelphia, and Chicago. With such concerns terms vary greatly, and the question is largely a price problem. A large percentage, however, is stated to sell on terms of net 30 days, although spot cash or net 10 days, net 60 days, and net 4 months are also given. Some houses of this description note a decrease in the length of terms during the past few years, instances of change from 4 months to 60 days and from 60 days to 30 days being reported.

The old-line jobbers, through their association, in January, 1918, adopted a resolution effective March 1, 1918, in favor of terms of 7 per cent 10 days, 6 per cent 30 days, 5 per cent 60 days. Invoices were to be dated ahead about two months, December deliveries thus bearing February 1st dating, with the exception that January-February deliveries bear April 1st and July-August deliveries bear October 1st dating, no goods being dated March 1st or September 1st. Bills are due net in four months after the dating, and are subject to an interest charge of 6 per cent per annum thereafter. The same rate of interest is allowed for anticipation. On goods sold at net prices, no longer dating and no longer time is given. Goods shipped to Pacific coast territory, however, may bear longer dating, April 1st on December shipments, October 1st on June shipments, and 30 days extra on shipments during the other months. Although the matter of terms had been frequently discussed, no action had been taken prior to 1918, and no regular terms existed, although the terms which were adopted at that time, namely 7 per cent 10 days, 6 per cent 30 days, and 5 per cent 60 days, had been previously in general employed.

In addition there are book houses who put up sample books of the fabrics which they have purchased from the mills. The tailor displays the book to his customer, who selects the style he desires, and the tailor then orders a suit length of the style from the book house. There is stated to be little difference in the relative strength of the book house and the regular jobber as a link in the distributive chain in the various sections of the country. Certain book houses combine jobbing with their

regular business to a greater or lesser extent. The customer of the book house requires little credit, due to the fact that he shifts to it the burden of stocking the goods. In consequence, a large portion send cash with order or accept C. O. D. shipments, while some remit on receipt of goods or when sending the next order, and others receive 10 days, end of month terms or 30 days. The same principle underlies the granting of time as in the case of proximo terms, namely to group invoices in the case of frequent shipments. The annoyance incident to C. O. D. shipments is also avoided. Orders for large quantities of material bear 30 or 60 days, and only rarely are longer terms extended, such as 90 days in the case of orders for stock. For years a discount of 7 per cent has been granted, but this was abolished in certain cases last year.

Men's Clothing.

Manufacturers of men's ready-to-wear clothing may be divided into several classes. The first distinction is between makers of trade-marked clothing and makers of clothing unidentified by either trade-mark or label. The former will feel to a greater extent the desirability of greater concentration of work under their direct supervision, and the large inside factory is in fact on the increase everywhere but in New York. On the other hand, particularly in that center, the system of contracting is still largely employed. Between the two, the medium-sized house, it is felt in some quarters, is being driven out, due to the disadvantages inherent in its competition with both the small manufacturer on low grade and the large manufacturer on better grade garments. The relative capital of the typical cutting house is small compared with its turnover and in consequence "the whole structure rests on the ready salability of the cutter's product,"¹ the chain extending from retailer through cutter to manufacturer of cloth.

As is well known, the industry is distinctly seasonal, although during the past two years activities have continued to a greater extent over the entire 12 months. The duration of the spring season is from about November 15th to May 15th, the cloth being bought during the previous June, July, and August, and the salesmen soliciting orders during September, October, and November. Deliveries are generally made after January 1st, being heaviest in February and March, and reorders follow in the spring. The cloth for the fall season is bought in December, January, and February, orders are received during March, April, and May, and deliveries are heaviest in August and September. Little, in particular in the higher-priced lines, is made for stock.

¹ Cherington, *The Wool Industry*, p. 204.

There is no standardization of terms in the industry. It has been the practice for the manufacturer to date shipments ahead, so as to permit the retailer to dispose of part of his purchases before being required to pay the manufacturer. Thus up to recent years terms were mostly 9 per cent for cash within 10 days, or 7 per cent 10 days, with December 1st dating on fall goods and June 1st dating on spring goods. In certain cases, however, the dating was November 1st or November 15th on fall goods and May 1st or May 15th on spring goods. Some houses have distinguished further between different classes of goods, suits, for example, being dated November 1st and overcoats December 1st, or May 1st being specified on spring goods and June 1st on distinctly summer goods. Late shipments, for example, after April 1st or April 10th on spring and October 1st or October 10th on fall goods, in many cases bore terms of 7 per cent 10 days, 60 days extra, or 7 per cent 60 days. In certain cases 7 per cent e. o. m. has been given instead. Tradition in the industry sanctioned terms of 6 per cent 30 days, 5 per cent 60 days, and net 4 months. In some cases, however, 7 per cent 10 days, 5 per cent 30 days, and 4 per cent 60 days was given. Some manufacturers have considered accounts as due net at the close of 90 days. Other manufacturers, although permitting 30 days or longer settlements with correspondingly reduced discounts, have given formal terms of only 7 per cent 10 days, and have thus been able to insist upon payment of accounts of financially involved customers at any time after the expiration of the initial 10-day period. Anticipation has been generally permitted at the rate of 6 per cent per annum.

During the last few years many manufacturers have shortened terms, although the larger number continue to employ the regular terms. Some have eliminated the dating entirely, while others have granted datings that would not be so far advanced in the season. Some manufacturers give no terms longer than 5 per cent 30 days, or 5 per cent 60 days without dating. There has also been a tendency away from the high discounts which were formerly almost universal. Some manufacturers, while retaining season dating terms, give only 8 per cent for immediate payment, others 7 per cent 10 days, and 5 per cent for payment on dating dates, such as June 1st and December 1st, or specify that accounts, while bearing the customary 7 per cent discount at the dating period, are due net in 30 days thereafter. The principal controversy, however, concerns the use of so-called "net terms." By the phrase is meant merely terms where the discounts are small, and correspond to the cash discounts generally in vogue in other lines. An instance is afforded by the terms of 2 per cent 10 days, net 60 days, without season dating, now employed by certain manufacturers. Other

houses employing these terms give datings, such as April 1st. The use of such terms at times when making quantity sales to large dealers is also noted. A study made several years ago states that some high-grade clothing is sold on net 10 day terms,¹ and some manufacturers give terms of net 10 days with July 1st dating on summer clothing. Several houses which had adopted shorter terms are reported to have gone back to the longer terms in 1919.²

The subject of standardization of terms has been discussed for some time by committees of manufacturers and retailers. The latter prefer standardization in the regular or old way, and have objected strongly to the introduction of net terms, which are favored by some wholesalers. Other wholesalers, however, believe that the higher discount terms have tended to accelerate collections. In consequence, no definite arrangement has been consummated. The opinion has been expressed that the many changes just noted in terms in the industry during recent years do not represent any real standardization, but have been made from the point of view of the individual house.

Lack of rigid adherence to terms in the past was noted.³ Retailers, it has been said, often bought on one basis and wished to settle on another. The liberal credit policy followed, due in some measure to keen competition, encouraged merchants who were inexperienced and possessed inadequate capital to engage in the retailing of clothing, and who then required the manufacturer's aid in carrying the merchandise. The long terms forced the manufacturer to carry the retailer, although a goodly percentage of the latter were in a position to take the best discounts. On the other hand, because of the high discounts given, wrongful deduction of discounts was frequent. Thus some retailers expected to give notes bearing interest at 6 per cent per annum, while obtaining the full cash discount, and succeeded in obtaining such concessions from manufacturers. During the last two years, however, and in particular during the past year, collections have improved greatly and there have been very few failures among retailers. The retailer has done a large volume of business at high prices, while payments by him have also been stimulated through a desire to obtain his full allotment of merchandise. The question has been raised as to what extent the merchants who would have failed in the absence of the unusual trade activity of the last few

¹ Bureau of Foreign and Domestic Commerce, Miscellaneous Series No. 34.

² It is stated that in view of the present high money requirements, recent developments in the industry have not operated appreciably to change terms. There undoubtedly, however, have been many "close-out" sales, in particular by smaller manufacturers, such sales often being made on a spot cash basis.

³ The material in this paragraph relative to conditions in the past has been taken from a paper on Datings and Discounts, read by Mr. Ira D. Kingsbury before the convention of the National Association of Creditors, June, 1914. The paper is reproduced in the Bureau of Foreign and Domestic Commerce, Miscellaneous Series No. 34.

years will remain on a permanently improved basis when conditions become more normal, or whether they will again slip back.

The manufacture of trousers may be considered as a separate branch, although the number of houses making trousers exclusively has declined during the past two decades. Advantages accrue from the addition of other lines, such as summer clothing and overcoats, and these combinations are found as well as combination with the manufacture of work clothing. Regular clothing manufacturers also make trousers to a greater or lesser extent. Trousers bear either terms of 7 per cent 10 days, 6 per cent 30 days, and 5 per cent 60 days, which are stated to have been largely initiated by clothing manufacturers, or terms of net 60 days, with a discount of 2 per cent 10 days in some cases, or in other cases 1 per cent 10 days, 30 days extra. Some manufacturers give only net 30 days. Inasmuch as trousers are also distinctly seasonal, a spring dating of April 1st or May 1st and a fall dating of September 1st, October 1st, or November 1st are generally given for January to February and June to July or August shipments, respectively.

Terms for work clothing range from net 30 days to 2 per cent 10 days, net 60 days. In general, however, terms are stated to be 1 per cent 10 days, 30 days extra, net 60 days. Some years ago 1 per cent 10 days, 60 days extra was also given. One house selling on terms of net 60 days gives 30 days extra on a trade acceptance settlement. The same datings as in the case of trousers are given to some extent, and in both branches anticipation at the rate of 6 per cent per annum is permitted in certain cases.

In recent years the tailor to the trade, who in a central factory makes clothes to measure, which are ordered through retailers or agents in the various sections of the country, has been an increasingly important factor in the industry. In addition to his regular business, he is often employed by large retailers to make up clothes after their own styling, just as is the regular manufacturer who does not feature his own name. Although found in all sections of the country, the tailor-to-the-trade branch is stated to be considerably larger in the Southwest than either the ready-made or merchant-tailoring branches. As is to be expected, it is relatively stronger in the smaller than in the larger centers.

Distinction in terms is made by the tailor to the trade according to the credit rating of the customer. Those with good rating in general receive net 30-day terms, monthly settlement, for example, by the 10th, being permitted in certain cases. During the war one of the leading houses lengthened the 30 days to 60 days. Some houses provide the 10-day terms for purchasers of lesser rating. A deposit, such as \$5 per suit and \$1 per pair of single trousers, when placing the order, and

C. O. D. terms are generally required in the case of those who do not have a rating sufficient to entitle them to credit on open account. While the larger houses do most of their business upon 30-day terms, certain houses are known in the trade as C. O. D. houses and deal almost entirely with unrated merchants. In certain cases cash in advance is required, or else a guaranty, the regular monthly settlement being permitted in the latter case. Some houses allow a cash discount, such as 2 per cent 10 days or 3 per cent cash in advance. Regular ready-made clothing manufacturers in certain cases sell also made-to-measure garments, terms being net 30 days or in some instances net cash.

Jobbing in men's ready-made clothing is very small. In the study above referred to, data obtained from 64 manufacturers showed that 98.21 per cent of the output was sold to retailers and only 1.29 per cent to jobbers. The latter are stated to be largely disappearing, except where they have goods made up for themselves to be sold under their own labels. The cheaper goods are mainly handled, the manufacturers of trade-marked clothing selling their product direct to the retailer, in general granting the latter exclusive agencies. Even in small-town and country trade, which is now their chief field of activity, their work is confined mainly to the sale of working clothes. A few jobbers also exist who dispose of slow lines for manufacturers on commission, or else purchase the same outright. Terms of jobbers are reported to vary greatly, and no definite statement can be made.

Women's Outer Garments.

There are several distinct branches in the women's garment industry. Cloak and suit manufacturers generally do not make skirts, although there is a distinct tendency for them to do so. The same manufacturer at times makes both skirts or suits and dresses, although the large majority of manufacturers confine their attention to either article. It is estimated that 95 per cent of ladies' waist manufacturers specialize in this product. There are thus the cloak and suit, skirt, dress, and waist branches, each of which has its distinct identity. In addition to the manufacturers, there are so-called "jobbers" or stock houses, who, however, practically create their own styles, furnish their own materials, and have their garments made up by submanufacturers and contractors. Contracting in the industry, while it figures largely, is however less important than for men's wear, due to the greater number of small cutting concerns.

Jobbers are found in all the larger centers where the manufacturers are located. New York is the largest center in the cloak and suit indus-

try, its output being estimated in the census of 1910 at approximately 70 per cent of the total output of the industry, and it produces finer goods than other centers. Cleveland is noted for the production of staple articles, and Philadelphia, Boston, and Chicago are also large centers. St. Louis is the second largest center in the skirt industry. There are many jobbers, but no stock houses, and there are relatively few small concerns, as is the case in New York and elsewhere. The principal dress centers include New York, Chicago, Philadelphia, St. Louis, Cleveland, Cincinnati, Boston, and Los Angeles.

The industry differs in some important particulars from the men's clothing industry. There are fewer trade-marked lines, and the agency and branch store are not employed. The larger New York stores are stated to seek the smaller manufacturers rather than the larger factories for the greater part of their stock, and have a large part in the creation of their styles. The time between orders by the store and delivery by the cutter is very short, and cutters endeavor to keep goods in process of manufacture as small as possible, seldom getting far ahead of orders actually in hand.

Sales are made to department stores, specialty shops, and catalogue houses. Seasons differ somewhat. Cloak and suit orders in New York are placed from July 15th to October 15th and from January 15th to about two weeks before Easter, shipments occurring respectively in August, September, and October, and February and March. The dull-est months are December and June. In Cleveland, however, orders are stated to be taken further in advance of the season and deliveries made earlier, beginning about July 1st and January 1st, and being heaviest from July 15th to September 15th and in February and March respectively. In the skirt industry heaviest sales are made in July and August and in January and February, heaviest deliveries being approximately one month later. These seasons must be further subdivided in view of the change in the separate skirt business from a staple character to the manufacture of novelties for sport wear, etc., which has made it necessary to carry a far larger stock. St. Louis has selling seasons running from June 15th to August 1st and from December 1st through January and in some years through the early days of February, heaviest deliveries being from August 1st to September 15th and in February respectively for fall and spring seasons. October, November, and December are the dull months in the skirt industry.

In the dress industry there are four seasons. These extend roughly from the middle of June to the middle of August or September, from the middle of September to the 1st of November, from December until the middle of March, and from the middle of March until about the

1st of June, deliveries being made approximately one month later. The dull months are June and November. Seasons, of course, differ according to the character of the garment and the material employed. Thus winter-resort fabrics will precede summer cotton garments and sport wear, while midwinter wear and fur-trimmed garments are somewhat earlier than garments for formal functions and evening wear. It is generally believed that there has been a tendency during the last two years for seasons to become interlocking. Selling for the fall waist season occurs in July and August and for spring in January and February, heaviest deliveries being in August and September and in March, April, and May, respectively, although the business is practically continuous.

In New York City, the Garment Conference Council of Wholesalers and Retailers adopted a resolution in July, 1917, fixing maximum terms, which was later confirmed by the respective local associations of cloak and suit manufacturers, dress and waist manufacturers, and garment "jobbers," and concurred in by various associations of retailers. Terms had previously been very mixed, ranging from net up to discounts as high as 16 per cent, and the abuse prevailed of deduction of excess discounts by purchasers. In the dress and waist industries 10 per cent was called regular. The maximum terms adopted were 6 per cent 10 days, 7 per cent 30 days, 8 per cent 60 days, or so-called "net" terms, namely, 2 per cent 10 days, 1 per cent 30 days, net 60 days, the price being advanced correspondingly in the former case to compensate for the difference in discount. A strictly net basis is also permitted, as are e. o. m. 10 day terms. The endeavor was first made to offer merely a 2 per cent discount, but in consequence of the opposition of the retailers, who favor a high discount (as also in men's clothing), a compromise was effected after about a month whereby the two optional sets of terms were specified. It has been stated that the majority of cloak and suit and skirt manufacturers selling low-priced garments offer only the low discount and short dating. Few dress and waist houses in the association employ the "net" or strictly net terms. The length of time given will vary with the individual credit risk, and thus some buyers receive only 30 days, etc.

Cloak and suit manufacturers in the Cleveland market, however, have adopted no uniform terms, although "the consensus of opinion has been to sell as nearly as possible on a net basis with 60 to 90 days' dating," while at the same time offering a reasonable cash discount. Up to about 10 years ago the majority of houses sold on terms of from 7 to 10 per cent 10 days, with proportional discounts for payments within 60 days and 90 days. Terms now range from 2 per cent 10 days, net 30 days,

to 5 per cent 10 days, 2 per cent 10 days, 60 days extra, but the majority give terms of 4 per cent 10 days or 2 per cent 10 days, 60 days extra. Many houses give season datings of March 1st and September 1st, the dating on suits in some cases being one month earlier than on coats. The difference in practice between New York and Cleveland with respect to dating corresponds to the difference in practice noted above with respect to orders and deliveries, there being no heavy purchasing in advance in New York, and goods being ordered for delivery when needed.

It is stated that skirt manufacturers in New York who are not members of the manufacturers' association in general adhere to the terms adopted by the garment conference, although they are reported often to give extra terms. Prevailing terms among St. Louis houses are fairly uniformly 3 per cent 10 days, 2 per cent 30 days, although special terms of 8 per cent 10 days to 10 per cent 10 days are allowed to firms of exceptional credit. Jobbers' terms in the main are 2 per cent 10 days, net 60 days. While some members of the trade claim that terms were formerly flat 3 per cent, but that about 4 years ago eastern competition forced concessions during several seasons, terms on the whole show no great changes during the past decade. The city trade, which amounts to but a small portion of the total, receives e. o. m. 10 day terms. In other markets it is reported that 10 per cent 10 days is largely given.

The standard maximum terms were not accepted by all New York City dress houses which belonged to the dress and waist association. Prior to that time discounts ranged from 3 per cent up to as much as 16 per cent in some cases, while 10 per cent was called regular, as was noted above. Terms of houses in New York which are not members of the local association, as well as of houses located in other markets, vary greatly, and instances are found of net terms of 10, 30, and 40 days, while discounts range from 2 per cent to 8 per cent, e. o. m. terms primarily due to the policy of the individual house, others distinguish (in general not over 2) such as 2 per cent 10 days, 1 per cent 30 days, net 60 days, or 3 per cent 10 days, 2 per cent 30 days, and special terms according to account. While many state that differences in terms are primarily due to the policy of the individual house, others distinguish between cheaper dresses, which are stated to be generally sold on shorter terms and lesser discounts, and medium and fine dresses. Thus one authority states the former are sold more largely on terms of net 10 days or 2 per cent 10 days, the latter on terms of 8 per cent 10 days, in some cases with e. o. m. terms or 30 days extra, and some extremely high-priced dresses on terms of 8 per cent 10 days extra or 7 per cent

10 days 60 days extra. It is also agreed that the last few years in general have witnessed a shortening of terms and an abolition of the old extremely high discounts.

Waists are generally sold on terms of 8 per cent 10 days, in some cases with e. o. m. terms for the better grade and 2 per cent 10 days for the cheaper grade. It is stated that there is a general tendency to eliminate the 60-day clause. Collections on the whole are reported fairly prompt, payment on the average being made within 30 days from receipt of goods.

Fur Manufacturing.

Raw and dressed furs are purchased by manufacturers from importers and dealers. At times manufacturers import their raw materials extensively, but the great bulk of the business is done through dealers. Both manufacturers and dealers have their raw furs dressed by "dressers and dyers," which is a separate branch of the industry. The business in the past has been a one-season business, but in recent years the fashion for summer furs has given the industry two seasons.

The matter of standardizing terms in the industry has been discussed for eight years or more, but no formal action has ever been taken, and it is very generally conceded that the establishment of fixed rules in regard to the matter would be extremely difficult if not entirely impracticable.

The prevailing terms are 2 per cent 10 days or 7 per cent 10 days December 1st, and 2 per cent 10 days January 1st, on merchandise shipped after July 1st, and 7 per cent 10 days July 1st on merchandise shipped prior to that date. Houses making fine goods usually give 7 per cent 10 days with both datings, while houses making cheap goods give 2 per cent 10 days December 1st and 7 per cent 10 days July 1st. As there are more firms making cheap goods than fine, more goods with the December dating bear 2 per cent than a 7 per cent discount. It has been suggested that the existence of a 7 per cent discount with the July 1st dating may be due to the fact that when the fur trade was a one-season business special inducements were necessary to stimulate early orders, and these persisted even after the industry had assumed a two-season character.

Variations from these terms are, however, frequent. The customer with a poor credit rating may have to take a lower discount, although this is not generally practiced. Exceptionally large discounts, such as 6, 8, 10, 12, and up to 16 per cent, are given in certain cases where desired by large retailers. During the year much larger use of the trade acceptance by manufacturers is reported, although it is not by any means

a general trade practice. Large use is made of it in the purchase of skins from importers or dealers.

Prior to 1912 over 50 per cent of the total product was shipped on memorandum or consignment. Serious abuses, however, resulted, and in that year a rule was adopted in the trade of prohibiting the practice. Shipment of goods on approval, to remain not longer than three days in the customer's hands, is, however, permitted. It is estimated that not over 10 per cent of the product at present is shipped on memorandum, the greater part of which is on three days' approval.

Millinery.

The organization of the millinery industry is complex. There are four principal branches. Of these the millinery jobbers are the chief, but the term is somewhat inaccurate, for many of them make their own hats, in large part import their specialties, and sell feathers, etc., direct to the retail trade. There are also hat manufacturers who make untrimmed and banded hats, which are made by machine and not by hand, and who sell almost exclusively to large jobbers, or in a very few cases to large retailers. The trimmed-hat houses manufacture trimmed hats and sell almost exclusively to retail dealers. In addition, there are specialty houses handling flowers, feathers, etc.

The hat manufacturers who sell to the jobbers have a seasonable business lasting from three to four and one-half months each season. The trimmed-hat manufacturers have a longer season, owing to the scarcity of trimmed hats, their season lasting about 10 months each year. At the present time there is an active and well defined movement on foot, sponsored by the Millinery Chamber of Commerce of the United States, looking toward the establishment of a 12 months' business for all branches of the millinery industry, with a resultant sale of seasonable millinery for each season of the year. It is stated that this movement is meeting with great success.

Terms of millinery jobbers are now fairly standardized. First among their organizations to adopt terms was the Millinery Jobbers' Association in 1900, which now covers the territory between Columbus and Denver, and St. Paul and Dallas. The terms as revised in 1910 called for a maximum dating of April 15th and October 15th on goods shipped prior to February 15th and August 15th, respectively. On goods shipped subsequent to these dates it was optional with members to allow 60 days dating, the discounts being 6 per cent 10 days, 5 per cent 30 days, and 4 per cent 60 days from value date. Anticipation at the rate of 6 per cent per annum was permitted.

Beginning with the spring season, 1918, datings were fixed at April 1st and October 1st for shipments prior to February 1st and August 1st, respectively, while the clause relating to goods shipped subsequent to these dates remained unchanged. The terms of 4 per cent 60 days were, however, eliminated, and a clause instead substituted providing that no discount was to be allowed after 30 days.

One of the principal purposes in the formation of the National Millinery Association in the East, covering the Atlantic seaboard from Boston to Atlanta, in the winter of 1917, was to improve credit conditions, in particular in view of the high percentage of bad-debt losses. Prior to that time terms varied greatly, but most houses are stated to have given terms of 7 per cent 10 days, 6 per cent 30 days, with May 1st and November 1st datings. From Boston it is stated that terms had been usually 7 per cent 10 days, 5 per cent 30 days, with datings of April 15th and October 15th, and a flat 60-day dating to all large accounts. In Baltimore, in addition to 7 per cent 10 days and 5 per cent 30 days, 4 per cent 60 days, 2 per cent 90 days, and net 4 months were given, with 60 days dating, as well as net terms of 2 per cent 10 days, 1 per cent 30 days, net 60 days, strictly net 30-day terms, and without discount privilege according to price quoted. In Atlanta terms were 7 per cent 10 days, 5 per cent 30 days, with April 1st and October 1st datings on shipments prior to February 1st and August 1st, respectively, and 60 days extra on subsequent shipments.

The datings and shipment dates fixed by the National Millinery Association are identical with those of the Millinery Jobbers' Association. Terms of 4 per cent 60 days were, however, permitted, no discount being allowed after 60 days, and terms of 7 per cent 10 days *e. o. m.* were permitted. At the same time, a similar change was made by houses on the Pacific coast, the datings being changed from April 15th and October 15th to April 1st and October 1st, and terms being specified as 6 per cent 10 days, with anticipation at the rate of 6 per cent per annum, or 7 per cent 10 days quoted. Sixty days extra has been given on other than early shipments.

The hat manufacturers have terms, which have been in effect for many years, of 6 per cent 10 days, 5 per cent 30 days, with datings at March 1st and September 1st, and no datings thereafter, other than *e. o. m.* terms in some cases.

Trimmed-hat houses on July 1, 1917, through their association adopted terms of 6 per cent 10 days, 60 days extra, or 7 per cent 10 days. Terms previously in use were 7 per cent 10 days, 60 days extra, or 8 per cent 10 days, and many houses are still employing these terms. In 1919 several millinery jobbers reported the use of net terms on

trimmed hats, and a committee on discounts was accordingly appointed by the Millinery Jobbers' Association, but at the recent convention it was decided not to sell them net.

Among the specialty items, flowers and feathers are sold on terms of 7 per cent 10 days, with May 1st and November 1st dating, or 10 per cent 10 days e. o. m.

The trade acceptance is little used in the industry. It was adopted in June, 1919, by the Raw Ostrich Feather Importers' Association, for use where requested by the seller on all accounts not liquidated by the 10th of the month following purchase, terms being 10 per cent 10 days (e. o. m. in some cases), 9 per cent 30 days, 8 per cent 60 days, 7½ per cent 90 days, 7 per cent 4 months. This association urged the use of trade acceptances in a letter in 1919 to the Millinery Jobbers' Association, but the latter did not deem them practical for the millinery business at that time. Millinery braids were sold to millinery jobbers and hat manufacturers upon terms of 6 per cent 10 days, with datings of April 1st and October 1st, but practice as to payments is stated to be very lax. On March 1, 1920, purchasers were advised that the season dating would be eliminated, and terms would be 8 per cent 10th e. o. m. or 6 per cent 10th e. o. m., 60 days extra, but the effect is stated to have been nullified through instructions given by customers to ship goods on January 1, making due dates and discounts 8 per cent February 10th, or 6 per cent April 10th.

Men's Hats.

The principal branches of the men's hat industry, aside from the preparation of the raw material, are the manufacture of felt hats, straw hats, Panama and fiber body hats, and cloth headwear. The interests of these branches are closely interwoven. Manufacturers sell to jobbers and to retailers direct, a few, but usually of large producing capacity, selling to jobbers almost entirely, while others sell only to retailers and others have their accounts almost equally divided. Of an estimated production of finished hats amounting to 10,000 dozen per day, about 40 per cent is stated to go to the jobbing trade, and the remaining 60 per cent to the retail trade,¹ one-third of this 60 per cent being the output of manufacturers who buy the bodies. In addition, there is an estimated production of 800 dozen bodies per day sold to small and medium-sized factories throughout the country for finishing and trimming. The quality of products sold to jobbers is reported much lower on the average than of that sold to the retailer direct, but it has been stated that with

¹ One authority, however, places the percentages for felt hats at 20 per cent and 80 per cent, respectively.

the constantly rising prices the proportion of better grade hats being sold to jobbers has materially increased. Retailers sold direct will naturally be located more largely in the larger centers.

Turning to the several branches, the manufacture of felt hats is divided into several distinct branches, in the manner just indicated. Certain manufacturers manufacture or purchase hatter's fur, making their own hat bodies and finishing and trimming the hats complete ready for sale; but others manufacture or purchase hatter's fur and manufacture only the hat bodies in the rough, which are sold to and become the raw material for the third class, known in the trade as dry shops, who finish and trim the hats complete ready for sale.

Considerable variation in terms is found as between different firms, although in each branch of the industry certain terms are recognized as regular. Standard terms of manufacturers of hat bodies in the rough are net 30 days, while it is stated that formerly up to net 90 days was given.

There is no general difference in the terms on which manufacturers who engage in the entire process and the dry shops sell. Standard terms to jobbers are 10 per cent 10 days, e. o. m., with sliding scale of reduced discounts for various periods of deferred payments. In years of business depression the discounts have been known to be increased to 12½ per cent, and in exceptional instances to 15 and even to 17 per cent. For many years standard terms to retailers were 7 per cent 10 days, 6 per cent 30 days, with a loss of 1 per cent per month for further deferred payments, and these terms are still most generally observed. In recent years a number of manufacturers changed to terms of 2 per cent 10 days, net 30 days, and various authorities report either a general decrease in the discount or shortening of terms, one manufacturer selling to retailers thus reporting elimination of the 60 days extra formerly given on all shipments. There is also a considerable number of manufacturers who transact their business on terms of 6 per cent 10 days, 5 per cent 30 days, and net thereafter, while others employ terms such as net 10 days and net 30 days. It has been stated that manufacturers of the medium and cheaper grades have granted larger discounts than manufacturers of the finer grades. It is reported that eastern manufacturers generally grant an additional time allowance, such as 30 days extra, to Pacific coast purchasers, while to accounts located in the territory west of the Mississippi River and east of the Rocky Mountains certain manufacturers grant 20 days additional.

Silk hats are reported to be generally sold on net terms.

The straw-braid hat industry before the war was distinctive in that the manufacturers booked the majority of orders from the early part of

July to the early part of October, for the entire season's business, running from July to July. Shipments were made at the discretion of the purchaser, and for many years terms were 7 per cent 10 days May 1st to the jobber, and 6 per cent 10 days, 5 per cent 30 days, June 1st, to the retailer. The bulk of shipments were made during March and April, necessitating storage by the manufacturer until that time. In 1917 the three larger Baltimore manufacturers found great difficulty in making their shipments at the customary time, due to transportation conditions. In consequence, for the year commencing July, 1918, straw-hat manufacturers with few exceptions decided upon revision of their methods, requiring the purchaser to take the goods as they came from the factory. In order to encourage early purchasing, shipment, and payment, terms were changed to 10 per cent for payments on or before October 10, 1918, with a decrease in discount of 1 per cent per month for later payments, thus making the lowest discount 2 per cent for payments after May 10th and before June 10th. Manufacturers, in addition, were enabled at their option, in case of financial stringency, to bring their bills due on any date upon demand. For the season commencing July 1, 1918, a decision, however, was reached to return to the old terms but to allow also an additional 2 per cent to purchasers taking goods as they came from the factory.

Terms of manufacturers of Panama and fiber body hats, while not strictly uniform, in general are 2 per cent 10 days, net 30 days May 1st, although in some instances May 1st net is specified. Some manufacturers producing straw hats also grant the same terms on Panama and fiber body hats as on straw-braid hats, which have been noted above.

The trade acceptance is reported to be little used by manufacturers of men's hats, and is employed by perhaps less than 5 per cent of the number of manufacturers, although some firms employ it with very great success. As to collections, it is estimated very roughly that 75 per cent of buyers take the highest discount and 20 per cent pay on a 30-day basis, although another estimate places the figure for those taking the highest discount at 50 to 60 per cent for the felt-hat industry. Individual manufacturers in this industry report individual percentages ranging from 65 to 75, and over 80 per cent taking the highest discount, 30 per cent and 15 per cent taking the second discount, and 2.2 per cent and 5 per cent taking over 30 days. Additional time taken beyond 30 days will almost always affect credit standing adversely.

Jobbers' terms are largely 2 per cent 10 days, 30 days extra, but deduction of the discount by purchasers is permitted even if payment is made at the expiration of 90 days. Some houses grant Pacific coast customers 60 days extra in place of 30 days. It is stated that prior to

about four years ago high discounts prevailed, such as 6 per cent or 7 per cent 10 days, 60 days extra.

Men's Furnishings.

Collars and shirts.—A study made several years ago¹ showed that of the output of 42 reporting establishments, 59 per cent was sold direct to retailers, as against 39 per cent to jobbers. The practice varied with the individual firms, 17 selling their entire product to retailers, as against 4 to jobbers, while 11 other establishments also sold part of their output to jobbers. By far the greater proportion of high-grade lines of shirts is sold direct to the retailer, the portion sold to jobbers consisting very largely of work shirts and low-priced lines. It has been estimated that from 80 to 85 per cent of the output of collars is sold direct to the retail trade. Jobbers are stated to have been formerly of much greater importance in the industry than at present. Manufacturers of shirts frequently also make other products, such as pajamas, men's muslin underwear, boys' blouses, and overalls.

Terms of sale of collars are quite uniformly 6 per cent 10 days, 5 per cent 30 days, while in the case of shirts, considerable variety is found, the study quoted above reporting terms to jobbers as usually 2 per cent 10 days, 60 days extra, and to retailers, by the greater number of manufacturers, as 2 per cent 10 days or 6 per cent 10 days, both with 60 days extra,² but ranging from net 10 days to 8 per cent 10 days, 60 days extra. Certain of the manufacturers of finer grade goods selling direct to the retail trade report elimination during the last decade of the 60 or 90 days extra dating on collars which prevailed to some extent prior to the war. This dating is now given by certain of these manufacturers only on season orders. Some manufacturers of this class of goods report a change in their terms on shirts from 6 per cent 10 days, 5 per cent 30 days to 2 per cent 10 days, 60 days extra. The above study states that terms on shirts in considerable measure depend upon the quality of merchandise and the importance of the customer, concessions being made on new accounts or important sales, while demands for extra discount and dating were frequent. The trade acceptance is not employed by the great majority of manufacturers. A high percentage of discounters is noted. It is reported that collections in the industry are generally prompt, though varying of course with general

¹ U. S. Bureau of Foreign and Domestic Commerce, Miscellaneous Series, No. 36.

² Certain manufacturers from whom data were obtained in the present study report, however, that 90 days extra is also given.

business conditions. A leading manufacturer estimates that 40 per cent pay within the 10 or 30 day discount period, 20 per cent pay within 60 days, 20 per cent within 90 days, and the balance in one or two months thereafter, while another reports his receivables as averaging 45 to 50 days' sales.

Men's Neckwear.—It has been estimated that by far the larger proportion of men's neckwear, at least 80 per cent, is sold direct to retailers by manufacturers. Certain of the firms selling the jobber also sell the large retailers, in particular department stores. As a general rule, neckwear sold to the jobber is of a lower grade. A number of manufacturers produce also allied lines, such as handkerchiefs, mufflers, etc.

Prevailing terms among the larger manufacturers are stated to be 6 per cent 10 days or 5 per cent 10 days, 60 days extra, a considerable number of manufacturers giving 7 per cent 10 days, 60 days extra (or 8 per cent 10 days) up to the middle of the war period, when they reduced the discount to the former figure. It is reported, however, that a large amount of neckwear is sold upon terms of 6 per cent 10 days, 60 days extra, 7 per cent 10 days also being granted in such cases. Some manufacturers employing these terms reduced the discount to 2 per cent or 1 per cent several years ago, in order, it is stated, to enable the sale of goods by jobbers at accustomed prices per dozen. In certain cases e. o. m. terms are given, and some manufacturers quote only terms of 10 days. The trade acceptance is infrequently employed. In most cases the related lines which are manufactured are sold on the same terms as the neckwear.

Suspenders, belts, and garters.—It has been estimated that of the cheaper grades of suspenders and belts 70 per cent is sold by manufacturers to jobbers, while of the better grades 90 per cent is sold direct to the retailer. For garters 70 per cent or more is estimated to be sold to jobbers, in particular of the better grades, while low-priced garters are stated to be sold primarily direct to chain stores handling low-priced merchandise.

Terms are reported to vary from 1 per cent 10 days without further dating to 7 per cent, 60 days extra, the majority of manufacturers selling on terms of 2 per cent 10 days, 60 days extra. E. o. m. terms are given in certain cases. It is stated that up to three or four years ago certain manufacturers who sold the retail trade employed terms of 6 per cent 10 days or 7 per cent 10 days, 60 days extra, but that most of them have since changed to 2 per cent 10 days, 60 days extra. Little use is made of the trade acceptance. Several leading manufacturers granting 60 days extra report that from 80 to 90 per cent of accounts are paid within 70 days.

Corsets.

Corsets, corset waists, and brassières are sold by the manufacturer almost entirely direct to the retailer. Trade-marked goods are not sold to the jobber. The amount handled by the latter is confined to the lower grades and does not, it is stated, exceed at the most 5 per cent of the output.

Terms to retailers are largely 6 per cent 10 days, 60 days extra, although a few manufacturers allow a discount of 7 per cent instead, and a very small number, who usually do only a local business, have terms of 2 per cent 10 days, net 30 days. On the Pacific coast goods shipped from manufacturer's Pacific coast offices carry terms of 2 per cent 10 days, 60 days extra, inasmuch as merchandise is shipped f. o. b. point of purchase, and the 4 per cent differential covers the difference in freight charges to the manufacturer. There has been no change in the above terms for many years. Terms to jobbers, however, vary with the individual manufacturer from 1 per cent 10 days, 60 days extra, up to 7 per cent 10 days, 60 days extra.

Cloth Underwear.

The larger manufacturers of cloth underwear deal very largely through the jobber, while there is a tendency for the smaller manufacturers to sell directly to the retailer. While a little higher class of garment is possibly sold direct to the retailer, of whom there are a large number, smaller manufacturers tend to make more or less staple articles, as the manufacture of fancy goods requires more capital. It has been estimated roughly that about half of the total output of cloth underwear is sold to jobbers and half to retailers. There may be a tendency to more direct selling by manufacturers of women's garments, some estimates placing the proportion thereof sold to retailers at about two-thirds.

Manufacturers' terms of sale for cloth underwear to the jobber are relatively standardized at either 2 per cent 10 days, 60 days extra, or net 10 days, 60 days extra. While some of the largest manufacturers employ the net terms, it has been estimated that as much as 90 per cent of the total business is done on the former terms. Aside from poor risks not entitled to credit and one manufacturer (also making nightwear), who quotes 2 per cent 10 days, net 60 days, the only exception reported to the above terms was for some manufacturers of women's and children's underwear, whose terms instead are similar to the regular dry goods terms (with season dating), as will be noted below.

Terms to the retailer in general are even more largely 2 per cent 10 days, 60 days extra. Exceptions noted (employed by manufacturers

also making nightwear) include 30 days extra instead of 60 days and $2\frac{1}{2}$ per cent or 3 per cent discount in place of the 2 per cent, with net terms of 60 days. The only marked change in terms reported during the last 25 years has been the elimination of the season datings of May 1st and October 1st, with terms of 2 per cent 10 days, by the larger manufacturers.

Some manufacturers of women's cotton cloth and muslin underwear sell on terms of 8 per cent 10 days, 7 per cent 10 days, 60 days extra, to both jobbers and retailers, while others have regular terms of 3 per cent 10 days, 2 per cent 10 days, 60 days extra, but quote jobbers who so desire 8 per cent 10 days, adjusting the price accordingly. One manufacturer grants jobbers January 1 dating on merchandise manufactured during the summer months for January delivery, while in some cases the use of the regular dry goods season datings of April 1st and October 1st are reported by houses employing terms of net 10 days, 60 days extra.

Nightwear terms are similar. The former terms of 6 per cent 10 days, 60 days extra, are stated to have been changed to 3 per cent 10 days, 2 per cent 10 days, 60 days extra, in addition to which terms of net 10 days, 60 days extra, are also in use. In addition to the exceptions remarked above, the employment of terms of 5 per cent 10 days is reported. Very little use of the trade acceptance is reported in the cloth underwear and nightwear industry.

Gloves.

Distributive methods in the glove industry show little change during the last 25 years. Several estimates place the proportion of the output sold by manufacturers to retailers at 50 per cent or more, figured on the basis of dozens rather than dollars, and of this total 20 per cent are men's gloves. It has been estimated that 75 per cent of the output of work gloves and heavy gloves is sold to jobbers, while of the better grade of gloves 75 per cent is sold to retailers. In general, manufacturers of high-grade leather gloves sell exclusively to retailers and employ their own salesmen rather than work through selling agents. A larger jobbing business is stated to be done in the West than in the East.

Prior to about 1915 manufacturers' terms of sale were largely 6 per cent 10 days, 60 days extra to retailers, and 6 per cent 10 days, 5 per cent 30 days, with season datings of May 1st and November 1st to jobbers, with 30 days extra between seasons. Some manufacturers employed terms of 2 per cent 10 days, 60 days extra, or 7 per cent 10 days, which in certain cases have been retained. During the war, however, terms were largely changed to net 10 days, but have since been

generally lengthened to net 30 days or in some cases net 60 days, with the exception of the poorer credit risks, who largely are still quoted terms of net 10 days. The larger manufacturers make no distinction in terms according to locality, but it is reported that in some instances eastern buyers may be quoted net 10 days, whereas western buyers of equal credit standing may obtain net 30 days from the same manufacturer, and that some other manufacturers do not vary their terms but make the adjustment by changing the shipping dates. It is estimated that to-day 75 per cent of the business is done on net terms. In general buyers taking additional time are charged interest at the rate of 6 per cent per annum. Some manufacturers, however, have retained terms of 6 per cent 10 days, 5 per cent 30 days, 30 days extra, while terms of several manufacturers were given as 7 per cent 10 days, 6 per cent 30 days e. o. m., or as 2 per cent 10 days, net 60 days. The season dating has largely disappeared in the leather-glove industry, and is only found occasionally when a manufacturer wishes to ship before the regular season for deliveries. The trade acceptance is little used in the industry, although one manufacturer stated that he employed it in connection with 25 per cent of his business.

All the following information and data shall be considered and taken as part of the foregoing statements:

Is statement audited by a Certified Public Accountant? If so, by whom?

Have you any Contingent Liabilities for:	{	Notes of your customers or others discounted or sold	\$
		Are these included in your assets and liabilities	\$
		Accommodation paper or endorsements for others	\$
		Foreign Credits including discounted drafts	\$
		Notes exchanged with others	\$
		Litigation on or threatened	\$
		Guarantee of stocks, bonds or mortgages	\$

On statement date to what extent were you protected by any commitments or contracts regarding the purchase of material or merchandise for the current season?

Are all bad and doubtful assets excluded from above statement?

Are any of your assets pledged as security for loans, advances or other liabilities?

If so, please give details:

Are any of your Notes or Accounts Receivable pledged or assigned?

If so, what amount? \$

Fire insurance on Buildings and Plant \$

On Merchandise \$

Total \$

Other Insurance

Give basis of statement, whether actual inventory, by whom taken and date, or if estimate, by whom made and date

Time and amount of your Maximum Indebtedness during the past year

Month

\$

Time and amount of your Minimum Indebtedness during the past year

Month

\$

*Are you connected in any way with other enterprises and do you endorse or guarantee for others? If so, please give particulars:

Give the names of all Banks where accounts are kept, lines of credit given by each, and method of borrowing (against collateral endorsements or other security):

Method:

.....	\$
.....	\$
.....	\$
.....	\$
.....	\$
.....	\$

Do you ever borrow on collateral?

Other Banks, Bankers and Brokers handling notes and other sources of credit:

State whether the proceeds of loans applied for are to be used:

(a) For permanent investments, that is, investments in lands, plants, machinery, improvements, or transactions of a similar nature?

or

(b) For agricultural, industrial or commercial purposes, in connection with the production and distribution of commodities?

Do your plans for the current year involve any material additions or improvements to your real estate, plant or equipment?

If so, please state the nature and approximate cost

STOCKS, BONDS AND OTHER INVESTMENTS

Give description and cash market value:

*Included in Bills and Accounts Receivable are the following amounts owing from individuals, firms or corporations, acting in the capacity of agents for me:

Owing from

\$

\$

\$

Please explain connections of above agents with you, and state in what manner Bills and Accounts Receivable were contracted by them.

The maximum aggregate amount which the undersigned expects to borrow on short credit or sale of paper during the ensuing fiscal year is \$....., and the undersigned agrees that he will not during said period borrow any greater sum on such paper without first obtaining your consent thereto.

(Please sign here)

State of }
 county of } ss.

..... being duly sworn on oath deposes and says that he has read the foregoing statement by him subscribed, and knows the contents thereof, and that the same is true in substance and in fact to the best of deponent's knowledge and belief.

Subscribed and sworn to before me this
 day of 192.....

Notary Public.

(OVER)

STATEMENT OF REAL ESTATE

Give location, cash market value of each piece, and amount of encumbrance, if any:

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In whose name does your Real Estate stand of Record?..

Is your Real Estate in above statement listed at cost, appraisement or market value?

NAMES OF PRINCIPAL HOUSES EXTENDING YOU CREDIT

Do you discount or anticipate all your bills?

[illegible]

CORPORATION

CORPORATE NAME _____ ADDRESS _____
 BUSINESS _____

TO THE OLD COLONY TRUST COMPANY OF BOSTON

FOR THE PURPOSE OF PROCURING CREDIT FROM TIME TO TIME WITH YOU FOR OUR NEGOTIABLE PAPER, OR OTHERWISE WE FURNISH THE FOLLOWING AS A TRUE AND ACCURATE STATEMENT OF OUR FINANCIAL CONDITION ON _____ 19____, WHICH YOU MAY CONSIDER A CONTINUING REPRESENTATION, UNLESS NOTIFIED BY US TO THE CONTRARY, THAT OUR CONDITION HAS NOT FALLEN BELOW THE FOLLOWING STATEMENT. WE AGREE TO NOTIFY YOU IMMEDIATELY OF ANY SUBSTANTIAL CHANGE IN CONDITION OR AFFAIRS.

ASSETS		DOLLARS	CENTS	LIABILITIES		DOLLARS	CENTS
CASH ON HAND AND IN BANK				NOTES PAYABLE FOR MERCHANDISE			
NOTES RECEIVABLE OF CUSTOMERS:				NOTES PAYABLE, UNSECURED			
DUE WITHIN 90 DAYS				TO BANKS			
DUE BEYOND 90 DAYS				FOR PAPER SOLD			
ACCOUNTS RECEIVABLE OF CUSTOMERS:				TO OFFICERS, DIRECTORS AND STOCKHOLDERS			
CURRENT				TO OTHERS			
PAST DUE, LESS THAN 6 MONTHS,				ACCOUNTS PAYABLE FOR MERCHANDISE—NOT DUE			
PAST DUE OVER 6 MONTHS				ACCOUNTS PAYABLE FOR MERCHANDISE—PAST DUE			
ACCEPTANCES OF CUSTOMERS (ON HAND - NOT DISCOUNTED)				ACCOUNTS PAYABLE TO OFFICERS, DIRECTORS AND STOCKHOLDERS			
MERCHANDISE (AS PER INVENTORY OF _____)				TRADE ACCEPTANCES			
FINISHED (NEW VALUES) \$ _____				BANK ACCEPTANCES			
STOCK IN PROCESS (NEW VALUES) \$ _____				DEPOSITS OF MONEY WITH US BY OFFICERS AND OTHERS			
RAW MATERIAL (NEW VALUES) \$ _____				DIVIDENDS DECLARED AND PAYABLE			
U. S. GOVERNMENT BONDS AND SECURITIES				INTEREST ON BONDS DUE AND PAYABLE			
OTHER CURRENT ASSETS (ITEMIZE) _____				PROVISION FOR TAXES (FOR PERIOD ENDING _____)			
				OTHER CURRENT LIABILITIES (ITEMIZE) _____			
ASSETS PLEDGED TO LOANS:				NOTES PAYABLE, SECURED BY:			
NOTES RECEIVABLE				NOTES RECEIVABLE			
ACCOUNTS RECEIVABLE				ACCOUNTS RECEIVABLE			
TRADE ACCEPTANCES				TRADE ACCEPTANCES			
MERCHANDISE				MERCHANDISE			
SECURITIES				SECURITIES			
TOTAL CURRENT ASSETS				TOTAL CURRENT LIABILITIES			
DUE FROM CONTROLLED OR SUBSIDIARY CONCERNS { FOR MERCHANDISE / FOR ADVANCES				BONDED DEBT			
DUE FROM OFFICERS, DIRECTORS, STOCKHOLDERS AND OTHERS				KIND _____ RATE _____ DUE _____			
INVESTMENTS (ITEMIZE) _____				MORTGAGES OR LIENS ON REAL ESTATE (DUE _____)			
				CHATTEL MORTGAGES			
LAND (BOOK VALUES) (INCLUDE MORTGAGES, IF ANY, IN LIABILITIES)				OTHER LIABILITIES (ITEMIZE) _____			
BUILDINGS (BOOK VALUES) (INCLUDE MORTGAGES IF ANY IN LIABILITIES)				TOTAL LIABILITIES			
MACHINERY, EQUIPMENT AND FIXTURES (NEW VALUES)				CAPITAL & AUTHORIZED			
PREPAID EXPENSES				PREFERRED _____ ISSUED _____ DIVIDEND RATE _____ %			
GOOD WILL, PATENTS AND TRADE MARKS				COMMON _____ %			
OTHER ASSETS (ITEMIZE) _____				SURPLUS			
				UNDIVIDED PROFITS			
				RESERVES (ITEMIZE) _____			
TOTAL				TOTAL			

VALUE OF MERCHANDISE PURCHASED FOR NEXT SEASON'S BUSINESS AND NOT INCLUDED IN ABOVE ASSETS OR LIABILITIES \$ _____

OFFICERS

PRESIDENT	
VICE-PRESIDENT	
TREASURER	
SECRETARY	

AFFILIATED CONCERNS

COMMERCIAL PAPER BROKERS

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BANK ACCOUNTS

LINES GRANTED

REMARKS

Comparative Summary Statement.

MELLON NATIONAL BANK

CREDIT DEPARTMENT.

COMPARATIVE SUMMARY STATEMENT.

NAME,
ADDRESS,
STYLE OF BUSINESS,
INCORPORATED IN WHAT STATE, WHEN, AND WHETHER UNDER LOCAL OR SPECIAL ACT.

AUTHORIZED CAPITAL\$
PAID IN IN CASH.....
IN OTHER PROPERTY.....
TOTAL PAID IN\$

ASSETS	DATE			
CASH.....				
BILLS RECEIVABLE.....				
BOOK ACCOUNTS.....				
STOCK, FIN. AND UNFIN.....				
RAW MATERIAL.....				
TOTAL QUICK ASSETS.....				
MACH'Y AND FIXTURES.....				
REAL ESTATE.....				
TOTAL ASSETS.....				
LIABILITIES				
BILLS PAYABLE.....				
ACCOUNTS PAYABLE.....				
BORROWED MONEY.....				
TOTAL CURRENT LIABILITIES.....				
MORTGAGE ON REAL ESTATE.....				
BONDED DEBT.....				
LIABILITIES EXCLUDING C.S.				

SUMMARY.

TOTAL QUICK ASSETS.....				
TOTAL CURRENT LIABILITIES.....				
NET.....				
TOTAL ASSETS.....				
LIABILITIES EXCLUDING C. S. ..				
NET.....				
CAPITAL STOCK.....				
SURPLUS.....				
CREDIT LIMIT.....				

REMARKS;

Suggested Readings on Chapter IV.

Phillips, C. A.—Bank Credit, Chapters VII to XI.

Willis, H. P., and Edwards, G. W.—Banking and Business,
Chapter VIII.

Dewey, D. R., and Shugrue, M. J.—Banking and Credit.
Chapters XV to XVIII.

Questions and Problems on Chapter IV.

I.

THE NATIONAL PLUMBERS' SUPPLY COMPANY.

<i>Assets.</i>		<i>Liabilities.</i>	
Cash	\$7,570.30	Notes Payable	\$75,000.00
Bills Receivable		Accounts Payable	25,360.50
Accounts Receivable	32,300.50	Mortgage Payable	75,000.00
Merchandise	233,700.00	Accrued Liabilities	5,200.00
Land	12,000.00		
Buildings	125,000.00		\$180,560.50
Machinery & Fixtures	192,750.00	Capital	300,000.00
Patterns, dies, etc.	32,600.00	Surplus	155,360.30
	<u>\$635,920.80</u>		<u>\$635,920.80</u>

Memoranda.

Merchandise {	Finished	\$83,600
	Unfinished	57,200
	Raw	92,900

Depreciation on Buildings, Machinery, etc. 6 per cent per annum.

Insurance blanket \$200,000 in Mutual Co.

Discounts sometimes.

Sales last year \$500,000

Profits " " 12,000

Business now much better.

Management good, officers capable and honest, but volume of business not large enough for capital.

Proposition.

Want to borrow \$20,000 to buy material to finish several large contracts.

What is your decision?

2.

THE WELL-KNOWN CIGAR COMPANY

<i>Assets.</i>		<i>Liabilities.</i>	
Cash	\$7,360.50	Notes Payable	\$25,000.00
Due from Officers	6,000.00	Accounts Payable	11,360.70
Accounts Receivable	80,260.70	Due Officers	25,300.00
Tobacco	35,650.00	Mortgage on Real Estate ..	10,000.00
Cigars	55,200.00		
Real Estate	100,000.00		\$71,660.70
Fixtures	5,000.00	Capital	100,000.00
		Surplus	117,810.50
	<u>\$289,471.20</u>		<u>\$289,471.20</u>

Memoranda.

"Due from Officers" is a temporary overdraft.

"Due to Officers"—Dividends credited and not drawn.

Accounts Receivable: a large percentage due from saloon keepers.

Tobacco at cost—recent purchases.

Cigars in boxes at selling price less 20 per cent.

Real Estate, recent purchase—cost price.

Management: Officers are experienced, capable, honest, industrious, and thrifty.

Growing business in volume year after year.

Shows a fair profit right along.

Proposition.

Want to borrow \$25,000 to make a purchase of tobacco on unusually favorable terms. Promise to pay off the loan without fail in 90 days.

What is your decision?

3.

THE LUMBER TRADING COMPANY.

<i>Assets.</i>		<i>Liabilities.</i>	
Cash	\$7,620.70	Notes Payable	\$37,000.00
Bills Receivable	3,050.00	Accounts Payable	17,650.30
Accounts Receivable	92,730.50		
Merchandise	7,620.00		\$54,650.30
Furniture & Fixtures	1,500.00	Capital	50,000.00
		Surplus	7,870.90
	<u>\$112,521.20</u>		<u>\$112,521.20</u>

Memoranda.

Contingent Liability on acceptances discounted \$92,060.50
Discount all bills.

(1915) Annual Sales \$700,000.00

(1915) " Profit 30,660.00

Management very good. Officers thoroughly honest. Seem to avoid speculation.

Business growing steadily—almost too fast for capital employed.

Acceptances discounted are good names.

Proposition.

Want to borrow \$10,000 on company's note, to carry some lumber sold for delayed delivery.

What is your decision?

4.

THE OHIO VALLEY LITHOGRAPHING COMPANY.

<i>Assets.</i>		<i>Liabilities.</i>	
Cash	\$12,160.32	Accounts Payable (not due)	\$5,360.20
Accounts Receivable	15,260.22	Capital Stock	100,000.00
Realty and Plant	69,230.46	Surplus	18,781.70
Paper and Material	12,260.30		
Finished Merchandise	15,230.60		\$124,141.90
	<u>\$124,141.90</u>		

Memoranda.

Business done last Fiscal Year\$125,000.00
 Net Profit " " " 15,125.00
 Dividend Paid " " " 6,000.00
 Detailed statement of public accountant shows all the *items* of:

Earnings & Expenses.

Accounts Receivable.

Accounts Payable.

Management very good, officers capable, honest, industrious and enterprising.

Business growing steadily. Plant new and up to date.

Proposition.

Want a loan of \$15,000 to buy paper and other materials to take care of large orders.

What is your decision?

5.

THE INFANT SHOE MANUFACTURING COMPANY.

Assets.

Cash	\$55.20
Accounts Receivable	1,520.70
Merchandise	5,630.20
Machinery & Tools	4,730.00
Patterns, Lasts, Dies	2,790.00
Furniture & Fixtures	930.00
	<hr/>
	\$15,656.10

Liabilities.

Accounts Payable	\$2,130.70
Notes Payable	3,000.00
	<hr/>
	\$5,130.70
Capital	10,000.00
Surplus	525.40
	<hr/>
	\$15,656.10

Memoranda.

Loan to bank not reduced during year.

Management considered only fairly good.

Little progress made during past year.

Considerable improvement reported lately.

Proposition.

Want to borrow \$1,000.00 to buy leather and discount bill.

What is your decision?

6.

THE SOLID GOLD WATCH COMPANY.

Assets.

Cash	\$15,630.70
Accounts Receivable	159,340.20
Gold, Cases, Movements & Merchandise	213,356.30
Fixtures, etc.	5,000.00
	<hr/>
	\$393,327.20

Liabilities.

Notes Payable	\$130,000.00
Accounts Payable	27,560.50
	<hr/>
	\$157,560.50
Capital	150,000.00
Surplus	85,766.70
	<hr/>
	\$393,327.20

Memoranda.

Accounts Receivable due from high-grade jewelers throughout the country.
 Merchandise at *Manufacturers'* cost.
 Notes Payable
 \$60,000 to own banks.
 \$70,000 through note brokers.
 Credit in the trade and in the loan market is of the highest.
 Management very good, officers experienced, honest, capable, and energetic.
 Business growing very fast and showing a good profit year after year.

Proposition.

Want to borrow \$50,000 to put up an assembling plant and office building. Will reduce on this loan \$1,000 a month.

What is your decision?

7.

THE CHILDREN'S TOY STORE COMPANY.

<i>Assets.</i>		<i>Liabilities.</i>	
Cash	\$805.60	Notes Payable	\$10,000.00
Accounts Receivable	2,735.50	Accounts Payable	5,236.00
Merchandise	33,750.40		
Fixtures	5,000.00		\$15,236.00
		Capital	10,000.00
	\$42,291.50	Surplus	17,055.50
			\$42,291.50

Memoranda.

Merchandise carried at cost.
 Insurance 80 per cent on stock.
 Notes Payable { \$6,000 to bank.
 { \$4,000 to others.
 Indebtedness to bank not reduced during the year.
 Management fairly good although officers of company seem to be somewhat extravagant. However, they are considered honest and well meaning.

Proposition (In November).

Want \$2,000 loan to buy goods for the Christmas season. Promise to pay this off before Christmas.

What is your decision?

8.

THE INDIANA CARRIAGE MANUFACTURING COMPANY.

<i>Assets.</i>		<i>Liabilities.</i>	
Cash	\$9,535.60	Notes Payable	\$75,625.00
Bills Receivable	8,360.00	Accounts Payable	45,652.60
Accounts Receivable	113,762.40		
Merchandise	123,642.60		\$121,277.60
Land	12,000.00	Capital	100,000.00
Machinery & Fixtures	10,000.00	Surplus	56,023.00
	\$277,300.60		\$277,300.60

Memoranda.

Contingent Liability on discounted bills receivable\$41,650.00
 Land is a leasehold interest, the amount stated above having been
 paid on account of purchase price.
 Management: Men experienced and capable. Considered honest. Say they
 are doing a fairly large business but with relatively small profit.

Proposition.

Wish to renew their notes.

What is your decision?

9. How does kiting differ from the bank's ordinary business?

10. In what ways is bank credit like commercial credit, and in what ways is it different?

11. Assume you are an honest business man. What can you do to have a good credit statement? If you are dishonest, what would be your probable course?

12. On the basis of the following statements, how large a

THE GOLD WATCH COMPANY.

<i>Assets.</i>		<i>Liabilities.</i>	
Accounts & Notes Receivable	72,564.30	Notes Payable	55,350.00
Cash on Hand	4,352.70	Deposits	5,000.00
Fixtures	2,250.00	Accounts Payable	2,152.50
Gold Cases, Movements,		Capital	100,000.00
Diamonds, etc.	87,350.50	Surplus	4,015.00
	<hr/>		<hr/>
	\$166,517.50		\$166,517.50

Note.

Management: Good.

Officers: Honest, thoroughly reliable, experienced.

Sell to the better houses throughout the country.

Sell high-grade goods only.

Notes payable: \$40,000 to banks; \$15,350 to a subsidiary concern.

Deposits: From stockholders.

THE WOOLENS & TAILORS' TRIMMING COMPANY.

<i>Assets.</i>		<i>Liabilities.</i>	
Cash	\$452.25	Notes Payable	\$20,000.00
Merchandise	62,530.75	Accounts Payable	13,650.50
Accounts Receivable	19,350.52	Capital	40,000.00
Fixtures, etc.	700.00	Surplus	7,382.92
	<hr/>		<hr/>
	\$83,033.42		\$83,033.42

Note.

Management: Very good.

Officers: Thoroughly honest, capable, and industrious; experienced in their line.

Merchandise at market price, principally stable goods.

MATERIALS OF BANKING

Accounts Receivable: Very good and not old.

Notes Payable { \$7,500 to bank.
 { 12,500 to stockholders.

Accounts Payable: Most bills not due; usually discount.

Business: \$150,000 per annum.

THE BLANK LAUNDRY COMPANY.

<i>Assets.</i>		<i>Liabilities.</i>	
Cash	\$3,540.50	Notes Payable	\$13,152.50
Accounts Receivable	6,150.40	Accounts Payable	9,265.00
Merchandise	16,320.60	Mortgage	27,000.00
Land	8,000.00	Capital	40,000.00
Buildings	27,000.00	Surplus	5,594.00
Machinery	34,000.00		
	<hr/>		<hr/>
	\$95,011.50		\$95,011.50

Note.

Character of Management: Fair.

Officers: Honest and industrious.

Land at tax value.

Machinery value given by appraisal company.

Notes Payable: \$12,000 to bank.

Mortgage Loan: \$2,000 due every two years.

Business: \$2,000 per week.

THE JONES & BROWN ELECTRIC COMPANY.

<i>Assets.</i>		<i>Liabilities.</i>	
Cash	\$12,352.50	Notes Payable	\$15,000.00
Merchandise	42,352.60	Accounts Payable	2,252.50
Accounts Receivable	21,340.50	Capital	10,000.00
Fixtures	2,340.40	Surplus	
	<hr/>	Due Jones	25,566.75
	\$78,386.00	Due Brown	25,566.75
			<hr/>
			\$78,386.00

THE WHITE SOAP COMPANY.

<i>Assets.</i>		<i>Liabilities.</i>	
Accounts Receivable.....	\$140,842.42	Bills Payable	\$300,000.00
Bills Receivable	4,220.30	Accounts Payable	37,340.60
Cash	14,360.70	Capital Stock	1,000,000.00
Inventory: Finished product, Materials & Supplies	430,234.34	Surplus	246,302.16
Factory Buildings, Railroad Tracks, Storage Tanks, & Tank Cars...	260,350.00		<hr/>
Refineries & Fixtures.....	233,635.00		\$1,583,642.76
Good Will	500,000.00		
	<hr/>		
	\$1,583,642.76		

BALANCE SHEET OF A MANUFACTURER OF NOVELTIES

	AS OF 12-31					
	1913	1914	1915	1916	1917	1918
Current Assets.....	822M	882M	781M	796M	771M	767M
Current Liabilities.....	543M	566M	408M	377M	271M	141M
Surplus Current Assets...	279M	316M	373M	419M	500M	626M
Ratio of Current Assets to Current Liabilities	1.51	1.56	1.91	2.11	2.86	5.44
<i>Assets</i>						
Cash.....	42M	61M	63M	56M	74M	167M
Receivables.....	501M	529M	425M	452M	411M	255M
Merchandise.....	279M	292M	293M	288M	286M	345M
CURRENT.....	822M	882M	781M	796M	771M	767M
Plant.....	423M	419M	405M	408M	393M	365M
Deferred.....	113M	92M	69M	87M	85M	42M
TOTAL.....	1,358M	1,393M	1,255M	1,291M	1,249M	1,174M
<i>Liabilities</i>						
Notes Payable.....	432M	489M	360M	321M	187M	30M
Accounts Payable.....	56M	50M	24M	42M	33M	8M
Accruals.....	55M	27M	24M	14M	51M	103M
CURRENT.....	543M	566M	408M	377M	271M	141M
Capital Stock.....	809M	869M	869M	869M	869M	869M
Surplus.....	54M*	42M*	22M*	45M	109M	164M
TOTAL.....	1,358M	1,393M	1,255M	1,291M	1,249M	1,174M
*Negative						

COMPANY'S OPERATING DETAILS

FOR THE YEAR ENDED 12-31

	1914	1915	1916	1917	1918	1919
Sales.....	1,479M	1,232M	1,450M	1,618M	1,770M	2,316M
Net Profit.....	51M	27M	99M	111M	118M	195M
Dividends.....	39M	7M	32M	47M	63M	65M
Net to Surplus.....	12M	20M	67M	64M	55M	130M
						193M
						3,039M
						258M
						65M
						52M
						137M

On the basis of the comparative balance sheets from 1913 to 1921, what would be your judgment of:

- (a) The efficiency of the sales department?
- (b) The efficiency of the collection department?
- (c) The policy with respect to depreciation?
- (d) The soundness of the dividend policy?

How much would you be willing to lend them at one time?

CHAPTER V.

DEPOSITS AND LOANS.

Bank Deposits, Classes of.

1. Special-Bank acts as a warehouse and returns the identical thing.
2. General-Bank obligates itself to pay money in the form of legal tender.
 - a. Demand.
 - b. Time.

Origin of Bank Deposits.

1. Money and cash terms.
2. Borrowing.

Sources of Bank Deposits.

1. Bank deposits in other banks.
 - a. Reserve accounts.
 - b. Collection accounts.
 - c. To sell exchange.
2. Public deposits.
 - a. United States—secured by deposit of bonds.
 - b. Postal Savings.
 - c. State, county, city, or school district—often let by competitive bidding.
3. Individual deposits.
 - a. Commercial.
 - b. Professional or private.
 - c. Savings.
4. Special or extraordinary.
 - a. Certificates of deposit.
 - b. Court funds.
 - c. Certified checks.

Profits on Deposits.

A bank pays a small rate, or none at all, on its deposits and gets interest. It also offers certain services which induce people to deposit their money. These services are as follows:

1. Paying checks—taking risk of forgery.
2. Collecting checks and drafts.
3. Taking care of money.
4. Loaning money. (Being a depositor makes it easier to get a loan.)
5. Furnishing references, thus helping the credit standing of its depositors.
6. Paying interest, where the deposit is large.

*Reasons For and Against Paying Interest on Deposits.**For.—*

1. It is done abroad.
2. The depositor is entitled to share in profits earned on his deposits.
3. A bank gets interest when it makes deposits in other banks.

Against.—

1. It causes reckless banking.
2. The services to the depositor compensate for the deposit.

Loans.

Loans may be discussed from two standpoints, those of:

1. The borrower.
2. The bank.

The needs of the borrower and the form of the obligation depend upon:

1. The amount of working capital necessary.
2. For manufacturers, the length of the manufacturing process; for merchants, the length of time the goods are held.
3. The customs of the trade, *e.g.*, between wholesaler and retailer. Does the wholesaler finance the retailer and take the retailer's note, or does he sell on open account? Does the retailer borrow to discount his bills? Does he settle with a trade acceptance?

The bank by its loans wishes:

1. To have its funds profitably invested.
2. To be able to meet all of its obligations promptly.

Speaking broadly, the bank has receipts each day:

1. Deposits.
2. Repayment of loans.

The bank has withdrawals each day:

1. By depositors.
2. By the making or renewal of loans.

The bank has no control over the amounts deposited and withdrawn, but from experience it expects certain movements:

1. Withdrawals at the end of each week for payrolls.
2. Withdrawals at certain times for dividend payments.
3. Withdrawals at certain seasons for moving the crops.
4. Withdrawals at certain stages of the business cycle.

Provision to meet these expected withdrawals and any unexpected demands, must be made through the bank's control of its loans or by the sale of securities or the rediscount of some of its notes.

The bank will wish to have a few loans maturing each day, and heavy maturities at the times when it anticipates heavy withdrawals. However, the customers of the bank may not present paper for discount of the desired maturities. In this event, the bank buys paper from note brokers or perhaps loans money at call on the New York Exchange.

Classification of Loans by Duration and Security.

1. Duration.

Since the bank relies on its loans to meet its obligations, the character of the bank's obligations will determine the kind of loans it can make. Thus, a commercial bank with demand obligations must make its loans with shorter maturities than a savings bank with time deposits.

- a. Call loans.
- b. 30, 60, 90 days; 4, 5, 6 months.
- c. Demand loans, in form, are payable on demand by the bank, but very often in practice they are payable at the pleasure of the borrower.

2. Security.

Assuming the honesty of the borrowers, the repayment of

loans depends on the successful functioning of the business structure. If business is prosperous, loans will be repaid, but very often specific security is taken.

- a. Stock exchange collateral. The stock exchange provides a market where active listed securities can be sold at any time. The bank is protected against a decline by the margin it requires. It loans from 70 to 80 per cent of the market value of the securities and so has a margin of from 30 to 20 per cent. The collateral should be mixed and composed of active stocks so that there will be no big blocks to break the price if thrown on the market and so that it may be easily sold.
- b. Warehouse receipts. Produce exchanges furnish a continuous market for certain staples. Consequently warehouse receipts for these staples are excellent security for loans. The goods presumably will be marketed in a short time and provide the funds to repay the advance. Meanwhile, they are safe and in the control of the lender. Standardization and public grading of goods and good warehouse laws are necessary before this type of loan can be used.
- c. Indorsements of other banks.
- d. Mortgages. This form of security, however, is not good for commercial banks because mortgages are not readily marketable.
- e. Chattel mortgages. These are not much used.

Country Bank Loans.

The basis of loans of this sort is largely personal. Few borrowers furnish statements, but the bank directors usually know pretty well the borrower's condition. Often, too, the best credit risks do not borrow. It is to be noted that the entire amount of a loan is frequently drawn out, that customers seldom have good stocks and bonds to offer as collateral, and that loans in country banks are less liquid than those in city banks, many being based on yearly operations.

*Factors Affecting the Proportion of Loans from the Bank
Left on Deposit with the Bank.*

1. The character of the business. Farmers leave little.
2. The interest rate. The higher it is, the lower the proportion left.
3. The form of the loan. When money is loaned through note brokers, practically none is left on deposit.
4. The collateral. Little money is left when mortgage security is given.
5. Long maturities and renewals. These make for a low proportion left on deposit.
6. The amount borrowed. The larger borrowers leave less on deposit, since they have the alternative of using the commercial-paper houses.
7. Keen bank competition. This factor always makes for a smaller proportion left on deposit.
8. Prosperous times. During such a period, a higher proportion is left on deposit.

Single- and Double-Name Paper.

One good name is often better than two poor ones.

How Double-Name Paper May Originate.

1. A retailer gives his note to a wholesaler, who indorses it and discounts it at the bank.
2. Through accommodation indorsement.

Origin of Single-Name Paper.

The uncertainty of the greenback era was responsible for a marked shortening of the credit period. About 1880 the cash discount system was introduced, which impelled buyers to borrow directly from the banks.

Reasons for More Continuous Borrowing.

1. Improved facilities for storing and distributing, which lessen the seasonal character.
2. Wider use of labor-saving machines, which requires more fixed capital.

*Guaranty of Bank Deposits.**Arguments for—*

1. Individual distress is prevented.
2. Panics are prevented, and withdrawals in time of stringency are lessened.
3. Hoarding is reduced.

Arguments Against—

1. The strong are made to pay for the weak.
2. Loose and careless banking methods are encouraged.

Materials on Chapter V.**Wood Pulp Finance.¹**

From the Federal Reserve Bulletin, vol. 8, pp. 787-795 (July, 1922).

The following study endeavors to present the methods employed in financing wood-pulp operations, both by companies confining their activities exclusively to this product and by paper manufacturers. It includes such data relative to production and distribution as are believed necessary to afford an understanding of the financial aspects.

I. The Manufacture of Wood Pulp.

The wood-pulp industry is closely bound up with the paper industry. A majority of the establishments produce paper exclusively (they are frequently called converters), but the largest firms (measured both in terms of capital investment and in terms of value of product) produce both pulp and paper. Comparatively few mills make pulp exclusively, and they are relatively small in size. The situation is shown in the following table, giving census data for 1914 and 1919:

	[In thousands of dollars]				
	Number of establishments	Capital	Cost of materials	Value of product	Value added
Paper and wood pulp:					
Total, 1919.....	729	\$905,795	\$467,483	\$788,059	\$320,576
1914.....	718	534,625	213,181	332,147	118,966
Paper exclusively, 1914.....	495	177,413	103,678	158,427	54,749
Pulp exclusively, 1914.....	63	36,028	13,733	20,528	6,793
Paper and pulp, 1914.....	160	321,184	95,770	153,194	57,424

The manufacture of paper from wood pulp in the United States dates back to the early sixties, and to-day wood fiber is the most important product used. [Poplar was the first wood used, but to-day spruce leads all other kinds, comprising over 50 per cent of the total wood used. Hemlock is second, and poplar and balsam are rivals for third place. In addition, other products besides wood are still used, such as old rags, waste paper, etc.]

Wood is converted into pulp suitable for making paper by two different classes of processes—mechanical and chemical. That produced by the chemical process is in turn subdivided into three main groups, according to the respective chemicals used—sulphite, soda, and sulphate or kraft pulps. The grades of pulp thus made are used in different proportions in the various kinds of paper. The relative importance of these

¹ Prepared by Woodlief Thomas, Federal Reserve Bank of Philadelphia, in co-operation with the Division of Analysis and Research, Federal Reserve Board.

processes can be seen from the following table, which gives production of pulp by processes in the United States for specified years:

	[ooo omitted.]	1914	1919
Pulp wood.....	cords	3,048	4,430
Wood pulp.....	tons	2,893	3,519
Mechanical.....	"	1,294	1,519
Sulphite.....	"	1,151	1,420
Sulphate.....	"	52	120
Soda.....	"	348	412
Unclassified.....	"	48	48

Mechanical pulp or ground wood,¹ as it is more frequently called, is made by grinding up barked wood, then mixing the resulting material with water, and finally screening it. This process is the cheapest of all, but the pulp produced is inferior. In the production of pulp by chemical processes, the wood is cut into chips and then digested with a chemical liquor at high temperature and pressure for several hours. The chemical dissolves all the constituents of the wood chips except cellulose, leaving an unbleached pulp. After screening, it is ready for bleaching. Sulphite pulp, which is of very high grade, is made by the use of calcium and magnesium as chemical agents, while in the soda process caustic soda is employed for dissolving the nonfibrous parts of the wood. Sulphate or kraft pulp, noted for strength, is reduced by means of a liquor of caustic soda, sodium carbonate, sodium sulphite, and allied products.

The geographical distribution of the wood-pulp industry is shown in the following table, compiled from Lockwood's Directory of the Paper Trade for 1922:

	Paper mills	Pulp mills	Ground wood	Sul- phite	Soda	Sul- phate
Maine.....	29	49	24	16	6	2
New Hampshire.....	32	13	8	5	0	0
Vermont.....	18	9	7	1	0	1
Massachusetts.....	106	5	2	2	1	0
Connecticut.....	46	0	0	0	0	0
New York.....	166	98	75	20	3	0
New Jersey.....	45	0	0	0	1	0
Pennsylvania.....	73	16	2	5	8	1
Maryland.....	11	2	0	0	2	0
Virginia.....	12	10	2	1	3	3
West Virginia.....	5	5	2	2	0	0
Ohio.....	58	4	0	1	1	1
Indiana.....	30	0	0	0	0	0
Illinois.....	26	0	0	0	0	0
Michigan.....	56	15	4	8	1	2
Minnesota.....	9	9	6	2	0	1
Wisconsin.....	58	57	31	21	0	5
Other States.....	58	41	12	10	5	9
Total United States.....	838	333	175	94	31	25

¹ Data on processes of manufacture of pulp secured from Witham, "Modern Pulp and Paper Making," and from bulletin of the Department of Commerce, "By-products of the Lumber Industry, 1916."

From this table it will be seen that the pulp mills are nearly all located in States which have large timber resources, the five great pulp-producing States being Maine, New York, Wisconsin, New Hampshire, and Pennsylvania. The following table gives the actual 1919 output in tons for certain States, as reported by the census:

	Ground Wood	Sulphite	Soda	Sulphate
Total.....	<u>1,518,829</u>	<u>1,419,829</u>	<u>411,693</u>	<u>120,378</u>
New York.....	479,817	260,891	.....	(¹)
Maine.....	469,148	323,718	.....	(¹)
Wisconsin.....	225,843	233,591	.....	44,119
Vermont.....	69,946	(¹)	.....	(¹)
New Hampshire.....	41,192	(¹)	.....	.....
All other States.....	232,883	601,629	.....	76,259

Ground wood mills in particular are localized near their wood supply because of the bulkiness of the product. Over three-fourths of this grade of pulp is made in New York, Maine, and Wisconsin, which are also the chief newsprint producing States.

II. The Supply of Pulp Wood.

The primary operations in the production of wood pulp largely center around the cutting and purchase of wood by manufacturers. While the time of the year at which the different operations are carried on varies as to the grade of pulp produced, as to the section of the country in which the mill is located, and as to the respective policies of the individual manufacturers, uniform practices are found with respect to certain aspects.

Some pulp manufacturers produce pulp primarily for the market, while others manufacture for consumption in their own mills. Many of the latter also sell their surplus supplies. The larger companies with extensive capital resources usually cut their own pulp wood, and the smaller ones purchase their needs from other sources. Even many large firms that possess their own wood properties frequently purchase as much as possible from outside sources in order to conserve their holdings for future use. The division of the wood used between that cut from owned properties and that purchased thus varies widely among the different firms.

In purchasing wood, several different methods may be used. The pulp manufacturer may purchase directly as needed from wood-pulp jobbers or importers; he may contract with large or small operators, lumbermen, or jobbers for his yearly requirements; he may contract

¹ Included in all other States.

with or purchase directly on a small scale from local lumbermen and farmers such wood as they may be able to provide; and finally, he may secure timber rights to certain properties and operate them.

Wood may be bought in three states of preparation—rough, peeled, or rossed. The cycle for peeled wood is much longer than for the rough variety. Contracts are let during the spring and summer for the following year's supply, or may be postponed until fall or winter, but purchases are usually made before logging operations begin. In July and August the large operators frequently employ a small number of men to build roads, construct camps, and make other preparations for the coming season's output.

Cutting of the rough wood usually begins in this country about the latter part of August or the first of September, although in northern Canada it may be done in the summer because of the early heavy snows. The heaviest cutting is ordinarily done during the months of October, November, December, and perhaps January. The idea is to cut all the wood before the snow gets too heavy, or approximately by Christmas, after which snow-roads are made for the purpose of hauling pulp wood to the nearest streams. This hauling is done principally in the months of January, February, and March. The driving of the logs in the streams and rivers begins in the latter half of April, and sometimes the last of the logs do not reach the mills until late summer. Deliveries on contracts or on purchases by those mills that made no contracts begin about April and are heaviest during the three months following. Some firms report heavy purchases also in October and November. In States where driving is not done on streams the wood may be carried out during the winter by railway, and deliveries and purchases consequently begin earlier in the year than in the above illustrations, which apply chiefly to New England and New York.

The operations in supplying peeled wood are slightly different as to seasons and extend over a longer period of time. The bark will slip only in the spring when the sap is running, so cutting is not usually done until that time. Its period of greatest activity is in April and May. The logs are sawed and peeled during June and July. They are then hauled to the streams, where they remain until the drive of the following spring, when they are carried to the pulp mills. There they must remain until dried out and ready for use. Thus the cycle of operations extends well over a year. Of course, where the wood is hauled by railroad the length of time is much shorter. In the South, also, it is shorter, and cutting is usually done in the spring, while in the far South the cutting and purchase of wood is uniform throughout the year. Those pulp manufacturers who also operate lumber mills and use the

mill waste in the production of pulp usually secure a fairly regular supply of raw material throughout the year.

To summarize, we notice in general the process of supplying wood to pulp manufacturers has the following seasonal characteristics: June to November, placing of contracts; September to January, cutting of rough wood; September to May, cutting of peeled wood; January to March, hauling of wood; March to June, spring drive; January to September, deliveries on contracts and purchases.

The acquisition and carrying of large supplies of wood offers the greatest financial problem which manufacturers have to face, whether they operate their own properties themselves or under contract, or whether they purchase wood from other sources. Stocks vary within certain limits at different seasons and according to the policy of the individual manufacturer, but in general they are rather large. Most mills report that they ordinarily carry available for current use from 12 to 18 months' supply of wood, either in their yards or elsewhere. One firm states that on April 1st of each year it has at least 70 per cent of the total year's requirements on hand, which, in conjunction with later receipts, insures against a shortage. Most manufacturers try to keep a year's supply ahead, because few purchases can be made except at certain seasons and because the fresh green wood is not as good to work up into pulp as that which has been dried. The largest stocks are usually held in the fall, when deliveries on contracts are ended. A few mills, however, which have relatively small requirements, or which for special reasons are able to secure wood promptly, carry small stocks. Particularly in the South is this true, because of the regularity with which wood can be purchased during the year, and stocks sufficient for six months or less are frequent with mills securing their supplies from this section of the country.

Some information as to seasonal changes in stocks of pulp wood held by pulp manufacturers in different sections is given in the following table, showing data gathered by the Woodlands Section of the American Paper and Pulp Association:

	New England	New York	Pennsyl- vania, etc.	Lake	West	South	Total
<i>Sept. 1, 1921</i>							
Companies reporting...	6	17	5	19	3	.....	48
Consumption, 1920 (cords).....	678,790	532,639	34,411	505,550	103,615	.....	1,885,005
Cords on hand.....	960,310	720,208	19,572	522,061	64,332	.....	2,292,483
Contracted for.....	159,900	316,400	24,500	248,830	43,000	.....	792,630
Total stocks and con- tracts (cords).....	1,120,210	1,042,608	44,072	770,891	107,332	.....	3,085,113
Number of months' supply.....	19.8	23.5	15.3	18.3	12.3	.....	20.0
<i>Dec. 1, 1921</i>							
Companies reporting...	10	33	9	22	3	.....	81
Cords on hand.....	929,838	66,847	77,311	638,546	48,476	11,500	2,372,518
Days' supply.....	475	312	197	415	242	119	394
Cords contracted for...	175,660	251,873	98,000	313,977	48,842	12,000	900,352
Days' supply.....	1,122	251	342	216	150	200	212
Cords to be contracted for.....	.....	79,400	12,000	53,500	46,000	.....	190,900
Days' supply.....	.....	109	175	98	232	.....	139
<i>Mar. 1, 1922</i>							
Companies reporting...	8	24	10	17	4	3	66
Cords on hand.....	907,850	812,444	88,531	528,241	30,317	8,618	2,376,001
Days' supply.....	590	540	150	416	144	108	510
Cords cut or contracted for, 1921-22.....	68,821	341,380	181,400	275,762	30,976	21,300	919,641
Days' supply.....	48	226	306	217	147	266	267

Several points which these tables bring out may be noted. Stocks on September 1st exceeded 1920 production, which, incidentally, was extraordinarily large. These stocks are undoubtedly greater than usual, because manufacturers placed contracts in the fall of 1920 for a supply in excess of their needs in order to guarantee delivery of requirements, the depression in business came, and wood contracted for was delivered in full. Furthermore, production of pulp in 1921 was smaller than usual, thus leaving large stocks of wood. This accounts for the rather small volume under contract for 1921-22. Total stocks and contracts allow for a supply of wood sufficient for 20 months. December 1st statistics show stocks sufficient for 19 months. More detailed figures, showing ranges in stocks carried by individual mills on that date, are as follows:

Region	Number of com- panies	Number of days' supply held		
		<i>Minimum</i>	<i>Median</i>	<i>Maximum</i>
New England.....	10	14	163	570
New York.....	29	19	122	840
Pennsylvania and vicinity.....	7	90	150	753
Lake States.....	20	15	300	900
Western.....	3	27	130	355
Southern.....	2	85	...	150

The above information shows conclusively that smaller stocks are commonly carried by the Southern mills. It seems that the mills in the Lake States have the largest supplies.

The March 1, 1922, figures show increased stocks on hand as a result

of the winter's logging operations. The mills had on hand an average of 456 days' supply on September 1st, 394 days on December 1st, and 510 days on March 1st. The largest supplies and smallest amount of contracts outstanding, relatively speaking, are found in the New England mills, whereas in Pennsylvania the contracts are greater and, excepting the South, the stocks are smaller than in the other sections. For the country as a whole the total supply of wood on hand and contracted for as of March 1, 1922, is sufficient for practically two years, based on full operating capacity.

III. The Sale of Wood Pulp.

During the past few years it has been the custom of some pulp manufacturers to sell their pulp through dealers, but generally purchasers have contracted directly with the manufacturers for their requirements. These dealers are not as yet important factors in selling the domestic product. The largest producer of pulp for sale in the country reports that the amount sold by it through this medium is inconsiderable, and the maximum thus disposed of by any firm is 15 per cent of total output. Dealers, however, are important in the sale of foreign pulp, most of which comes from Canada and the Scandinavian countries.

Seasonal variation in sales and use of pulp are slight in the case of the chemical grades, but rather pronounced in the ground-wood branch of the industry. Under normal conditions production and shipments of chemical pulp are practically uniform throughout the year, with slight recessions in July and August and perhaps January and February. The demand seems to be fairly constant and plants are operated steadily every month. On the other hand, in the manufacture of ground wood there are undoubtedly seasonal changes. As this grade of pulp is produced by means of water power, the greatest manufacturing activity comes when the water in the streams is high. In the low-water period during the summer most of the mills are forced to close down. Therefore an excess supply is made in the spring in order to fill requirements during this nonproductive period. In the North, also, the streams may be frozen during the winter, and the manufacture of mechanical pulp therefore be temporarily suspended. In this branch of the industry there is thus rather pronounced manufacturing activity in the spring, curtailed production during the summer, and resumption of operations in the fall, which usually continues until the following summer, unless stopped by winter freezing.

Shipments of pulp to purchasers and its use in making paper, however, are practically uniform throughout the year. The only seasonal changes which may be noticed are a slight falling off during July and

August and perhaps in January and February, because of general slackening throughout all business at that time, which naturally affects the paper industry.

Stocks of wood pulp are, of course, dependent upon the manufacturing and selling phases. Pulp is so bulky that it is easier to store wood, which is kept out of doors, or paper, which is more compact, than it is to carry large supplies of finished pulp, and few plants have facilities for storing a large tonnage. Hence stocks of this product are as small as it is possible to keep them. The amount of pulp carried varies among the different companies from enough for a very few days' requirements up to a six months' supply. The latter figure, however, is rarely found. Manufacturers of the chemical grades seldom have over a 30 days' stock on hand, owing to the regularity of production possible in this branch of the industry, but in the case of ground wood the situation is of course different. Mills manufacturing this grade of pulp have to build up stocks in the spring to supply their requirements during the low-water period when it cannot be produced in sufficient quantity. Therefore stocks of mechanical pulp are ordinarily heavier in June than at any other time of the year.

A factor which makes for seasonal uniformity in the sale of pulp is the practice of contracting ahead for requirements. The length of time for which future contracts are taken varies with the type of the mill, but they seldom if ever exceed a year. Allotments are made to customers and are shipped when called for. Many companies report that they sell about half of their output on contract and the other half by means of spot sales, but in some cases all sales are for immediate delivery.

In the ground-wood market, contracts, where used, seem to cover a shorter period of time than in case of sulphite. They are commonly made to cover the period of low water when production is uncertain and are seldom longer than 90 days, although some Lake-States mills report contracts for as far ahead as six months. The practice among manufacturers of kraft and soda pulp is virtually the same as with sulphite producers, that is, contracts are commonly made early in the year for the total annual production. This is not altogether universal, however, for at least one large kraft manufacturer reports that in normal times 50 per cent of output is sold on three to six months' contract and the remainder for immediate delivery.

Within the last year or two the business depression and foreign competition have somewhat demoralized the pulp market, so that common practices have frequently not been observed. Because of uncertainty regarding prices, contracts became less common. Consumers expecting declines preferred to buy on the spot market. There-

fore at present hand-to-mouth buying is more common than purchasing by contracts.

The adjoined table and charts, prepared from monthly statistics compiled by the Federal Trade Commission, illustrate the above facts. The seasonal changes in production and stocks of mechanical pulp, the regularity in the monthly shipments and the amount used of both grades, and the relative uniformity in production and stocks of sulphite are apparent. The table and charts further show the small volume of pulp sold (shipments) as compared with the total used:

[Monthly average, in 1,000 tons, 1919-1921.]

	Production	<i>Mechanical pulp</i>		
		Stock on hand 1st of month	Consumption	Shipments
January.....	124,768	133,366	107,562	18,091
February.....	107,611	133,351	101,519	7,946
March.....	140,094	131,239	115,177	9,160
April.....	156,475	146,505	121,296	8,757
May.....	138,150	173,009	110,515	10,173
June.....	113,648	191,381	106,415	9,532
July.....	99,165	189,366	107,154	8,758
August.....	90,259	171,717	109,065	8,304
September.....	87,863	144,535	102,743	8,992
October.....	109,034	120,458	108,129	9,436
November.....	131,798	113,290	112,342	11,431
December.....	133,772	121,340	113,227	10,997

	Production	<i>Sulphite pulp</i>		
		Stock on hand 1st of month	Consumption	Shipments
January.....	29,441	7,031	20,743	7,746
February.....	25,938	8,080	18,496	6,326
March.....	27,026	9,115	19,855	6,512
April.....	26,084	9,733	18,904	7,287
May.....	26,850	9,634	19,655	7,416
June.....	27,723	9,383	19,953	7,966
July.....	26,923	9,184	19,222	8,451
August.....	28,672	8,437	20,758	8,655
September.....	28,699	7,691	20,577	8,619
October.....	31,541	7,186	22,284	9,430
November.....	35,739	7,048	21,937	9,143
December.....	28,888	7,197	21,212	7,469

Terms of sale in the wood-pulp industry are almost universally on the basis of net payment in 30 days. Among the rare exceptions are those of one manufacturer of sulphite pulp who also allows a discount of 1 per cent for cash within 10 days, another who gives 2 per cent, and another selling only a small amount of pulp whose quoted terms are 2

per cent in 10 days with no net option. One Middle Western firm observes the usual terms, except to agents, who are allowed a 3 per cent discount.

It is generally reported that accounts seldom or never run past due to any appreciable extent. Outstandings therefore on the whole equal about 30 days' sales, estimates ranging from 15 to 90 days, with only two above 45 days. The use of notes and trade acceptances is uncommon, although a number of companies report that such means of payment are employed occasionally.

IV. Financing the Wood-Pulp Industry.

During recent years the production of paper has been taken over more and more by large corporations, so that the average size of the individual paper company is increasing greatly. In addition to their mills, they own vast timberlands, power plants, and subsidiary companies which handle various phases of the production of paper. Heavy capital investment is required. For every ton of paper produced in 1919 there was a fixed capital investment of about \$150. In addition, the total amount paid for salaries, wages, and materials averaged about \$80, indicating the amount of operating capital further required.

Most important of the financial problems, in practically every instance where pulp is manufactured upon any appreciable scale, is that involved in securing the annual supply of pulp wood. This problem was particularly acute in 1921, and many companies had to call upon new and previously unused sources for funds to finance their large purchases of wood and the resulting enormous stocks which they had to carry through a period of falling prices and small sales. Incidents are told of manufacturers who in 1920 placed as many contracts as possible, and at high prices, hoping to get deliveries on enough of them to meet their requirements. They later found that more than was anticipated, and far more than would be needed, was being delivered. Their stocks were low at the beginning of the season and they bought wood from every source. When they had secured this wood, business began to fall off, and the banks had to be called upon as never before to finance these excess stocks. Some firms even went so far as to issue bonds to meet the current obligations arising out of such purchases.

The methods used in financing operations vary widely among the different mills in this country in accordance with location, sources of supply of raw materials, grades of pulp and paper produced, and relations with other companies. The practice among the Canadian companies is more uniform and is also employed to a certain extent in this

country, especially in the northern mills. A description of these methods is given to provide a uniform or standard practice from which departures may be noted.

Canadian practice.—The wood-pulp and paper industry is of greater relative importance in Canada than it is in this country. The wood resources are more extensive, the individual companies are larger, and the operations affect a greater portion of the community. The Canadian banks co-operate extensively with those having wood operations and advance the necessary funds as needed. In the Provinces of Quebec, New Brunswick, and Nova Scotia, and to a limited extent in northern Ontario, pulp wood is cut by small jobbers, who operate either independently or under contract with some mill. The operations of these jobbers, some of whom are small farmers who occupy the winter months in this way, are comparatively small, but over the country as a whole they are important. Any financial assistance which these men require is granted by the banks largely on the strength of their general standing. At most, such assistance is very limited and would be merely a direct loan on single-name paper.

Next come the wholesale dealers in pulp wood who buy from the jobbers and sell to the mills. As in the case of the jobbers, the standing of the individual borrower is, of course, the governing factor in the extension of credit. Furthermore, security by way of assignment of pulp wood, taken under section 88 of the Canadian bank act is likely to be required. The nature and method of such an advance and assignment are described later.

The operations of the mill owners form by far the largest part of the pulp-wood business. These owners work their timber limits themselves, and in addition some of them let out contracts to others for the working of part of these properties. The financing of these contracts is sometimes done by the mill owners and in other cases by banks. In connection with the operations of the mills, the banks are generally called upon to grant substantial financial assistance. Security is usually taken in such cases under section 88 of the bank act by way of an assignment of all pulp wood and products thereof manufactured and in the process of manufacture, also fire insurance and any additional collateral that might be called for, according to the strength of the account. Financial assistance from the banks would commence about the 1st of September and continue until the 1st of June or July. Advances are made from time to time to cover the pay roll or to meet such other expenses incident to the cutting and preparation of the wood, and reach their height in the spring to meet purchases made at that time. By summer considerable wood has been converted into pulp and sold. Gradual repayment begins

about June or July with funds coming in from sales. About the 1st of September or October all loans are usually paid up, and final liquidation is therefore effected before the commencement of new borrowing for the next year's operations.]

The pulp manufacturers are usually also called upon to finance the small contractors who cut from the properties of the company or from some other timberlands for the account of the company. Funds are advanced to them at intervals as needed. One payment may be made when the working force enters the woods; a certain percentage is generally paid when the wood is cut and delivered on the bank of the stream; a further percentage is due when the wood has been brought down the stream; and the final payment is generally made after the wood has been delivered to the mill. The manufacturer generally secures funds from the bank in the same manner as in financing his own operations.

The methods of obtaining secured loans from the banks under section 88 of the bank act may be briefly described. The would-be borrower makes a written application to the bank for a specified "revolving" line of credit for his business to cover a certain period of time. Goods offered as security are stated and described, giving location and quantities. The applicant agrees to give to the bank as often as required assignments covering all or a part of such goods, or bills of lading or warehouse receipts for them. Furthermore, it is agreed that the manager of the bank will be appointed the attorney of the applicant to give the bank the security that may be required and to sign such security for the applicant. If the loan is granted, the borrower signs the necessary promissory notes, stating amount, maturity, rate of interest, etc., and providing further that the advance was made under the terms of "application for credit and promise to give bills of lading, warehouse receipts, or security under section 88" made by the borrower on a given date. The manager of the bank is thereby appointed the attorney of borrower. An additional form is signed enumerating the bills and notes given the bank for the credit, listing and describing the goods provided as security, and certifying the title of the borrower thereto.

Only when the firm is exceptionally strong is no collateral at all required. A borrower is generally given his credit extensions in two classes—(1) the maximum extent of credit on the basis of assignment for a year and (2) the amount of trade paper that the bank will rediscount during the year. The borrower draws upon the bank for any sums which may be needed, and the amount is charged to his account and security is signed over to the bank to cover this amount. As the borrower sells the goods under assignment, the proceeds of the sales,

including cash, bills, notes, evidences of title and securities, and the indebtedness of the customer in connection therewith are considered the property of the bank, and when transferred to the bank the borrower is given credit therefor on his account. Interest is computed upon the varying amounts which are charged against the borrower during the period of the credit extension. The borrower is required to keep the goods insured and to pay all salaries and wages to his employees in the business with which the goods are concerned. Ordinarily when the pulp manufacturer makes a sale, he draws a sight draft on the buyer, which is either bought by the bank or taken by it for collection, and his account is credited therefor. Especially is the sight draft employed if the pulp is sold in the United States or abroad.

American practice.—A study of methods used by American producers reveals no such uniformity and no such co-operation between the banks and the manufacturers in handling the situation. We find at one extreme those companies which state that they are in such a favorable position as to have no financial problems. Others are able to finance themselves without assistance. Some are subsidiary to other companies and all finances are handled by the larger organization, and there are some good-sized companies, predominantly paper manufacturers, whose financial problems in connection with the manufacture of pulp are relatively insignificant. The larger number of companies, however, indicate that they require assistance in financing their inventories of pulp wood.

It was noted above that pulp manufacturers secure their wood requirements chiefly from four sources—(1) they may purchase wood directly from jobbers or merchants; (2) they may operate their own woodlands or (3) finance contractors who cut the timber therefrom for them; or (4) they may finance independent operators who secure wood for them from other properties. The amount of wood purchased directly on time is relatively small, and this practice is followed only by the smaller establishments. All of the other three methods require heavy financing at certain seasons of the year. Especially great are the capital requirements of those firms that carry on lumbering operations.

The problems of the smaller firms, however, which do not so operate, have to do simply with the financing of a sufficient quantity of pulp wood which it may be necessary to purchase within a few months in order to carry them through the year. But the mechanical pulp mills have the additional task during the period of high water of grinding enough wood into pulp to carry them through the summer. It so happens that these two burdens fall practically at the same season, that is, during the spring. Therefore manufacturers of this grade of pulp usually borrow

heavily in the winter and spring and pay off their loans during the summer and fall. A partial exception to this practice is found in the case of some mills which, because of severe winters, have to put in heavy stores of pulp wood, coal, and other supplies in the fall, and which therefore borrow heaviest at that time.

There is a fair amount of uniformity in the financing of wood purchases by northern manufacturers of chemical pulp. They usually make advances to operators at intervals as needed to supply the wood. These payments are roughly as follows: So many dollars per cord when the wood is cut, so many dollars when peeled and piled, a certain amount when the wood is delivered on the banks of the stream, and the balance 30 days after receipt of the wood at the mill. The pressure for funds is greatest in the early spring when the drives are started and the wood is beginning to arrive at the mills. At this time loans are secured at the banks. These loans are generally liquidated during the early fall, but those companies which are not so near their source of wood find it necessary to borrow from late spring to early fall when purchases of wood are being received, and to liquidate in the winter when sales are large.

In general outline, then, the operations involved in securing a supply of pulp wood are practically the same as with the Canadian mills, both for northern manufacturers located near their sources of wood and mills which have to purchase their supplies from a distance. The variations occur in regard to the seasons at which heaviest financing is necessary and in regard to the methods of financing employed. In the northern mills, as with the Canadian, pressure for funds is greatest during the spring drive and the months immediately following, when wood is being delivered at the mills. Loans for this purpose probably reach their maximum in late spring or early summer and are paid off during the fall when sales are large. However, for the other mills, deliveries are not made so promptly after cutting, and their inventories reach their highest point in the fall months. The loans obtained are paid off during the winter. If an aggregate of all borrowings for the purpose of financing the pulp-wood supply could be made, however, it would no doubt be found that they were heaviest during the spring months and lightest in the fall.

It is customary to pay for purchases of wood within one month after receipt, and under ordinary conditions most wood is paid for within at least 90 days. Occasionally, when wood shipments are unusually large, the purchaser may give a trade acceptance or a note, but this is uncommon. Often the buyer himself has not the funds, and he will borrow from his bank and pay the seller of the wood promptly. However, instances are found, particularly in the Great Lakes region, where wood

is bought on time or notes given for it. One Wisconsin manufacturer stated that in February, 1921, over 70 per cent of his current indebtedness was in the form of notes to lumbermen and 30 per cent represented bank loans secured by indorsements. This situation, however, is exceptional.

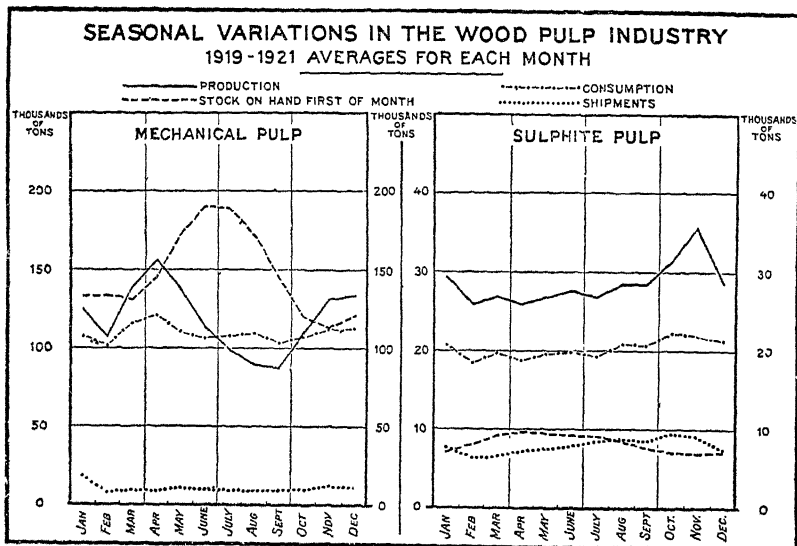
The maturities of notes given by the manufacturer to the bank for financing wood operations and purchases are generally from three to four months. This usually covers the period in which the company is in greatest need of funds, as generally after four months it is able to begin the liquidation of its current debts. It was seen that credit is usually obtained at the banks during the spring months to finance deliveries of wood, and these loans are liquidated in the late summer or early fall. Some loans have a maturity of as long as six months, while at the other limit a few firms report customary maturities as short as 60 days, but such cases are exceptions.

Funds are borrowed from banks almost universally on unsecured and unindorsed promissory notes. This is absolutely opposed to Canadian practice, where title to the wood is assigned to the bank. Only very rarely are notes secured by indorsement. Collateral loans are a little more common, but are by no means general. Some small middle western firms have given Liberty bonds as security when collateral was required. Borrowing on inventory of either wood or finished pulp, as is done in Canada, is extremely rare in the United States. The rediscounting of trade paper is also uncommon, as little of such paper is received in the course of business. A few firms, however, do make it a practice of rediscounting such paper as they obtain.

Practically all firms secure funds from banks in the locality in which their principal mills are placed and from one or more banks in the nearest large city or cities. The smaller firms do practically all their banking business with local institutions. The largest establishments, particularly those with offices in the bigger cities, however, almost without exception have established connections with banks in these cities. Most of the New England companies of any appreciable size, for example, obtain some, if not the greater part, of their loans from Boston banks. The New York State establishments have credit arrangements with financial institutions in New York City, and mills in Pennsylvania and near-by States do their banking in Philadelphia or New York, or both. Practically all of the largest eastern companies have banking connections in New York. In the Lake regions borrowing from local banks is probably more prevalent, but connections in the larger cities, such as Chicago and Milwaukee, are common.

A few large manufacturers sell their commercial paper in the open

market, but a relatively small portion of the total financing is accomplished by this method. Most of the firms selling their notes are also paper manufacturers, and the connection between the funds secured in this manner and the financing of wood purchases is more remote than is the case with bank loans. Within the last year or more, as previously stated, some pulp manufacturers have sold bonds in order to provide for their current indebtedness, but this practice is not very common.



Forms Used in Loans and Discounts.

F 51

\$ _____ St. Louis, Mo., _____ 19 _____



Gentlemen:-

We hereby apply this day for an advance of \$ _____ to be made under General Loan and Collateral Agreement on file with you and to be returned on _____ with interest at the rate of _____ per cent per annum.

Yours truly,

BROKER'S APPLICATION FOR A LOAN.

AGREEMENT.

Know All Men by these Presents,

That the undersigned in consideration of financial accommodations given, or to be given, or continued to the undersigned by the First National Bank in St. Louis, hereby agree with the said Bank that whenever the undersigned shall become or remain, directly or contingently, indebted to the said Bank for money lent, or for money paid for the use or account or at the request of the undersigned, or for any overdraft or upon any endorsement, draft, guarantee or in any other manner whatsoever, or upon any other claim, the said Bank shall then and thereafter have the following rights, in addition to those created by the circumstances from which such indebtedness may arise against the undersigned, or his, or its, or their executors, administrators or assigns, namely:

1. All securities deposited by the undersigned with said Bank, as collateral to any such loan or indebtedness of the undersigned to said Bank, shall also be held by said Bank as security for any other liability of the undersigned to said Bank, whether then existing or thereafter contracted; and said Bank shall also have a lien upon any balance of the deposit account of the undersigned with said Bank existing from time to time, and upon all property of the undersigned of every description left with said Bank for safe keeping or otherwise, or coming to the hands of said Bank in any way, as security for any liability of the undersigned to said Bank now existing or hereafter contracted.

2. Said Bank shall at all times have the right to require from the undersigned that there shall be lodged with said Bank as security for all existing liabilities of the undersigned to said Bank, approved collateral securities to an amount satisfactory to said Bank; and upon the failure of the undersigned to pay any indebtedness to said bank when becoming or made due or upon the failure of the undersigned at all times to keep a margin of securities with said Bank for such liabilities of the undersigned, satisfactory to said Bank, or if the undersigned shall be adjudged a bankrupt, either upon voluntary petition or involuntary petition, or if the undersigned shall make an assignment for the benefit of creditors or an insolvent assignment, or if the undersigned shall commit an act of bankruptcy, or if a receiver of the property of the undersigned shall be appointed or upon any failure in business by the undersigned, then and in either event all liabilities of the undersigned to said Bank shall at the option of said Bank become immediately due and payable, notwithstanding any credit or contract extending the time of payment of said indebtedness or time allowed to the undersigned by any instrument evidencing any of the said liabilities.

3. Upon failure of the undersigned either to pay any indebtedness to said Bank when becoming or made due, or to keep up the margin of collateral securities above provided for, or if the undersigned shall be adjudged a bankrupt, either upon voluntary petition or involuntary petition, or if the undersigned shall make an assignment for the benefit of creditors or an insolvent assignment, or if the undersigned shall commit an act of bankruptcy, or if a receiver of the property of the undersigned shall be appointed or upon any failure in business by the undersigned, then and in either event said Bank may immediately without advertisement, and without notice to the undersigned, sell any of the securities held by it as against any or all of the liabilities of the undersigned, at private sale or Brokers' Board or otherwise and apply the proceeds of such sale as far as needed toward the payment of any or all such liabilities, together with interest and expenses of sale, and including any stock transfer tax or other charges imposed by law, and the undersigned agrees to be responsible for any deficiency remaining unpaid after such application. If any such sale be at Brokers' Board or at public auction, said Bank may itself be a purchaser at such sale free from any right or equity of redemption of the undersigned, such right and equity being hereby expressly waived and released. Upon default as aforesaid, said Bank may also apply toward the payment of said liabilities all balances of any deposit account of the undersigned with said Bank then existing.

It is further agreed that these presents constitute a continuing agreement, applying to any and all future as well as to existing transactions between the undersigned and said Bank. It is expressly agreed that this agreement shall be binding upon the undersigned's heirs, executors, administrators, legal representatives and assigns.

Dated St. Louis, the day

of 19.....

BROKER'S LOAN AGREEMENT WITH THE BANK.

\$	Pittsburgh, Pa.	19
.....	after date	promise to pay to
the order of .....	.....	.....
.....	.....	100 Dollars
at the MELLON NATIONAL BANK without defalcation, for value received.		
Due .....	.....	.....
Address .....	.....	.....

C27-SM-12-18

PLAIN NOTE.

For a valuable consideration, _____ hereby absolutely and unconditionally guarantee the payment, in full, of the within note or any extension thereof, in whole or any part, when due; and hereby waive presentment, demand, protest and notice of non-payment and protest, and notice of any extension or extensions in whole or in part.

GUARANTEE OF NOTE.

6-117 10m 8-22

CLEVELAND, O., _____ 192_____

\$

_____ AFTER DATE FOR VALUE RECEIVED, _____ PROMISE TO PAY

TO THE ORDER OF

THE UNION TRUST COMPANY

_____ DOLLARS

at its OFFICE, in the City of Cleveland, O., with interest at _____% per annum from maturity, payable quarterly on the 1st days of January, April, July and October, until principal is paid and hereby authorize any attorney-at-law in the State of Ohio, or elsewhere, at any time after the above sum becomes due, to appear for the undersigned, in any Court in the State of Ohio or elsewhere, and to waive the issuing and service of process and confess judgment against the undersigned in favor of the payee or any holder of this note for the amount appearing due and the costs of suit and thereupon to release all errors and waive all right of appeal and stay of execution. The makers of this note, when more than one, shall be jointly and severally liable hereon.

No. _____

DUE _____ O. K. _____ JUDGMENT NOTE.

\$ _____ ATLANTA, GA. 19 _____
 AFTER DATE _____ PROMISE TO PAY TO

THE ORDER OF **THE ATLANTA NATIONAL BANK** DOLLARS

AT The Atlanta National Bank, ATLANTA, GA., FOR VALUE RECEIVED, WITH INTEREST AFTER MATURITY UNTIL PAID AT EIGHT PER CENT.
 PER ANNUM AS COLLATERAL SECURITY, FOR THE PAYMENT HEREOF, AS WELL AS ANY OTHER INDEBTEDNESS DUE

THE ATLANTA NATIONAL BANK HAVE DEPOSITED THE FOLLOWING

SHARES STOCK	DOLLARS, \$	EACH
"	"	"
"	"	"
BONDS	DOLLARS, \$	
"	"	
"	"	
NOTES	DOLLARS, \$	
"	"	
"	"	

WHICH OR ANY PART OR PORTION THEREOF OR ANY SECURITIES WHICH MAY SUBSEQUENTLY BE LODGED WITH SAID BANK IN LIEU OF ANY OF THE ABOVE, HEREBY AUTHORIZE SAID BANK, OR ITS PRESIDENT, OR ITS CASHIER, TO SELL WITHOUT NOTICE, AT PUBLIC OR PRIVATE SALE, AT THE OPTION OF SAID BANK, OR ITS PRESIDENT, OR ITS CASHIER, IN CASE OF NON-PAYMENT OF SAID NOTE WHEN DUE, APPLYING THE NET PROCEEDS TO THE PAYMENT OF THIS NOTE, INCLUDING INTEREST, ACCOUNTING TO _____ FOR THE SURPLUS, IF ANY, IN CASE OF DEFICIENCY, FROM-ISE TO PAY TO SAID BANK THE AMOUNT THEREOF, WITH LEGAL INTEREST, FORTHWITH AFTER SUCH SALE, OR IF COLLECTED BY AN ATTORNEY AT LAW TEN PER CENT THEREOF AS FEES.

AND _____ FURTHER AGREES, THAT IN CASE OF DEPRECIATION IN THE MARKET VALUE OF THE SECURITIES HEREWITH PLEDGED, OR WHICH MAY HEREAFTER BE PLEDGED FOR THIS LOAN, _____ WILL MAKE PAYMENT ON ACCOUNT, OR LODGE ADDITIONAL COLLATERAL SECURITY, SO THAT THE SAID MARKET VALUE SHALL ALWAYS BE AT LEAST _____ PER CENT. MORE THAN THE AMOUNT UNPAID OF THIS NOTE, EACH OF US, WHETHER PRINCIPAL, SECURITY, GUARANTOR, ENDORSER, OR OTHER PARTY HERETO, HEREBY SEVERALLY WAIVES DEMAND, PROTEST AND NOTICE OF DEMAND, PROTEST AND NON-PAYMENT, GIVEN UNDER THE HAND AND SEAL OF EACH PARTY

DUE _____ [SEAL]
 ADDRESS _____ [SEAL]
 COLLATERAL NOTE.

"C"—4M 133

St. Louis, Mo., 192..... Due.....

On Demand, and if no demand be made, then on the..... day of..... promise to pay to
the **FIRST NATIONAL BANK IN ST. LOUIS.** or order

DOLLARS,

together with interest thereon from date at the rate of..... per centum per annum prior to maturity, and from maturity at
the rate of eight per centum per annum and to pay said interest monthly, and if this note shall not be paid at maturity and shall be placed
in the hands of an attorney for collection..... further promise to pay, as attorney's fees for collection, ten per cent additional
on the full amount due hereon. Demand for payment, protest, and notice of dishonor are hereby waived by all who are or shall become
parties to this instrument.

Payable at **FIRST NATIONAL BANK IN ST. LOUIS.**

No.....

DEMAND NOTE.

DEPOSITS AND LOANS

123

Individual Deposits in All Reporting Banks, June 30, 1921. From the Report of the Comptroller of the Currency for 1921, p. 173.

[In thousands of dollars]

	Number of banks.	Individual deposits subject to check with- out notice.	Demand certifi- cates of deposit.	Certified checks and cashiers' checks.	Divi- dends unpaid.
State banks.....	18, 875	4, 196, 294	262, 985	134, 321	11, 070
Stock savings banks.....	978	12, 848	1, 250	226	49
Mutual savings banks.....	623	137, 882	30, 336	34	
Loan and trust companies.....	1, 474	3, 636, 542	91, 894	143, 144	10, 277
Private banks.....	708	53, 998	17, 902	208	24
Total.....	22, 658	8, 037, 564	404, 367	277, 933	21, 420
National banks.....	8, 154	8, 036, 561	290, 414	336, 650	32, 281
Grand total.....	30, 812	16, 074, 125	694, 781	614, 583	53, 701

	Savings deposits.	Time certificates of deposit.	Postal savings deposits.	Deposits not classified.	Total.
State banks.....	2, 987, 220	1, 132, 836	8, 026	2, 077, 036	10, 809, 788
Stock savings banks.....	304, 386	2, 271	4	122, 043	443, 077
Mutual savings banks.....	5, 394, 963	589	39	11, 338	5, 575, 181
Loan and trust companies.....	1, 472, 929	159, 697	24, 105	216, 343	5, 754, 931
Private banks.....	25, 082	21, 451	2	15, 230	133, 897
Total.....	10, 184, 580	1, 316, 844	32, 176	2, 441, 990	22, 716, 874
National banks.....	12, 957, 555	684, 039	36, 384	368, 397	12, 742, 281
Grand total.....	13, 142, 135	2, 000, 883	68, 560	2, 810, 387	35, 459, 155

¹ Includes approximately \$295,879,000 time certificates of deposit.

NOTE.—Does not include United States deposits.

Guaranty of Bank Deposits.

*From the Report of the Comptroller of the Currency for 1921,
pp. 187-193.*

Oklahoma.

In 1908, the year following the admission of Oklahoma into the Union of States, the legislature passed, and the governor approved, an act for the protection of depositors in banks of that State through a guaranty fund created by assessments upon the banks, based upon their average deposits.

The popularity of this legislation was manifested in the liquidation and reorganization as State banks of 30 national banking associations in 1908 and 52 in 1909. From 1910 to 1921, inclusive, 51 additional national banks in Oklahoma liquidated for the purpose of reorganizing as State banks. Of the total number of national banks liquidated for the purpose in question 36 subsequently re-entered the national system by conversion or reorganization, leaving the net loss to the national banking system of 97.

In May, 1908, there were in operation in Oklahoma 494 State banks with capital of \$6,640,000, total deposits of \$21,212,000, and assets amounting to \$29,645,000. On the same date there were 309 national banks with capital of \$12,212,000, deposits of \$44,705,000, and assets of \$70,517,000.

On June 30, 1921, there were 622 State banks with capital of \$15,551,000, deposits \$146,789,000, and assets of \$180,235,000. The number of national banks was 359, capital \$24,168,000, deposits \$239,997,000, and total assets of \$318,428,000.

Failures of Oklahoma State banks.—During the existence of the guaranty system up to November 1, 1921, there have been closed some 95 banks, the capital at date of closing, exclusive of 8, the amount of capital of which was not reported, aggregated \$1,935,500, and deposits guaranteed, in the sum of approximately \$11,050,000. It is reported that there has been collected from assessments on the banks of the State and placed to the credit of the guaranty fund, approximately \$3,645,000, collections from assets of failed banks \$1,931,000.

The law provides that if at any time the depositors' guaranty fund shall be insufficient to pay the depositors of failed banks, the banking board shall have authority to issue certificates of indebtedness, known as "Depositors' guaranty fund warrants of the State of Oklahoma," in order to liquidate the liabilities to depositors. The warrants bear 6 per cent interest from the date of issue and are a first lien upon the depositors' guaranty fund when collected, as well as a first lien upon the

capital, surplus, and undivided profits of each and every bank operating under the banking laws of the State to the extent of the liability of any such bank to the depositors' guaranty fund.

When a bank is closed the general policy of the banking department has been to provide for the organization of a new bank, giving to it the assets of the closed bank thought to be collectible, and the deficit paid to the new bank to protect the deposits, the banking board endeavoring to realize upon the assets so turned over to the bank.

The closing of 42 of the 95 banks was due to a decline in the value of the assets, poor management, and slow loans, inability to realize on loans, injudicious investments, and shrinkage in deposits. In 34 cases closing was due to criminal acts on the part of officers, including embezzlement, misapplications, or use of the banks' funds in speculation for private gain. In 19 cases the cause of closing is not of record here

From the incomplete data at command it would appear that of the closed banks some 66 were taken over by other banks, reorganized or placed in solvent condition and authorized to continue business, and that 16 banks liquidated or are in the process of voluntary liquidation.

Reports have been received to the effect that from November 1, 1920, to November 30, 1921, 44 banks in Oklahoma have been closed.

Within the past few weeks 56 applications have been received in this office for the conversion or reorganization as national banks of State banks in Oklahoma.

Texas.

The law providing for the guaranty of deposits in the banks of Texas became effective in 1910, and gives the banks the option of adoption of one of two plans: First, deposit of acceptable securities with the banking department, and, second, contributions to the guaranty fund, assessments therefor being based upon the volume of average deposits.

In a communication from Commissioner Hall, of the Department of Insurance and Banking of Texas, it is stated:

There are 1,022 State banks in operation in Texas, all of which, with the exception of 35, are guaranty-fund banks. These 35 banks are bond-security banks. They are required to file with the department a bond to the amount of their capital stock for the protection of their deposits, unless such deposits exceed six times the amount of capital stock and surplus. In that event additional bond is required for the amount of the excess above six times the capital stock and surplus. We are discouraging, and in fact refusing to permit the organization of bond banks, inasmuch as the bond furnished does not furnish ample or ready protection to the depositors in the event of failure of the bank. Since the guaranty-fund law became effective 51 State banks have been officially closed by the department. Thirty-five of these banks were closed within the past 12

months. For the protection of the noninterest-bearing and unsecured depositors of these 51 banks, the guaranty fund has paid out \$5,151,736. The condition of the guaranty fund on June 30 last was as follows:

Cash on hand in State treasury	\$584,472.54
Demand deposits in banks to the credit of State banking board.....	1,827,072.02

Total amount of guaranty fund	2,411,544.56
-------------------------------------	--------------

From the data submitted by the commissioner in relation to the 51 banks that have been closed it appears that their capital at date of closing was \$2,515,000, surplus and other profits \$356,911, all other liabilities \$15,327,406, deposits guaranteed \$9,215,473, liabilities not guaranteed \$5,823,943, deposits paid from the guaranty fund \$5,151,736, liabilities paid from sources other than the guaranty fund \$5,377,729, contributions (assessments) to the guaranty fund \$180,643. The salvage in so far as the shareholders are concerned was nominal, the amount being approximately \$75,000, distributed among the shareholders of seven of the banks, the shareholders of the other banks receiving nothing.

The failure of 13 banks was due to criminal acts of officers, etc., 34 to losses, of which 6 were on account of cotton loans, 1 was due to drought, and 3 not accounted for. The following statistics relative to the number, capital, total deposits, and aggregate assets of Texas State and national banks in 1910 and 1921 are of interest:

	Number	Capital	Total deposits	Aggregate assets (including rediscounts)
June 30, 1910:				
State banks, etc.....	608	\$20,694,282	\$46,562,769	\$79,005,629
National banks	516	43,561,000	183,846,567	294,405,854
June 30, 1921:				
State banks, etc.....	1,052	50,405,000	242,359,000	357,065,000
National banks	557	65,650,000	483,559,000	718,768,000

Kansas.

In 1909 an act providing for the guaranty of deposits in the banks of Kansas became effective. In advice of date of October 21, 1921, Bank Commissioner Foster stated:

The aggregate amount paid in on assessments by the banks of the State to the guaranty fund during the entire time the guaranty law has been in effect prior to June 30, 1921, was \$657,691. The amount of withdrawals from the guaranty fund for deposits paid to creditors of failed guaranteed banks prior to that date was \$28,700; the balance in cash to the credit of the fund was \$628,991. In addition to the cash there are bonds in the guaranty fund to the amount of \$1,135,622 to guarantee payment by banks of future assessments. We may say, however, that there are a number of failed banks in which it is not yet determined how much will have to be paid from the guaranty fund, but it may aggregate between \$300,000 and \$400,000.

From information furnished by Commissioner Foster it appears that during the operation of the guaranty law up to June 30, 1921, five guaranteed banks with combined capital of \$95,000, surplus \$42,945, and guaranteed deposits of \$827,080 failed. In three instances failure was caused by criminal acts of officials; one due to the failure of a large debtor, and one loss sustained upon worthless paper placed in the bank by one of the officials. In the same period there were 11 failures of "unguaranteed" banks, the combined capital of which was \$300,000, surplus and other profits \$66,600, and deposits of \$1,980,000. In five cases failure was due to criminal acts on the part of officials, one to speculations of officer, three to injudicious banking and inability to realize upon real estate and other paper, one to failure of a large debtor, and one was closed as the result of internal dissensions.

There follows a comparative statement in relation to Kansas State and national banks in 1909 and 1921:

	Number	Capital	Total deposits	Aggregate assets (including rediscounts)
Apr. 28, 1909:				
State banks.....	780	\$14,506,500	\$89,968,405	\$111,957,172
National banks.....	211	12,192,500	88,627,318	118,358,211
June 30, 1921:				
State banks.....	1,112	29,066,000	262,958,000	333,391,000
National banks.....	267	17,228,000	166,491,000	220,155,000

Nebraska.

The depositors' guaranty law went into effect in Nebraska in 1911, and in a communication from the department of trade and commerce of date October 24, 1921, it appears that the total assessments since the inception of the guaranty system amount to \$4,253,151, the drafts on the fund to pay depositors of failed banks to July 1, 1921, amounted to \$1,981,691, and the balance in the fund on that date \$2,312,746. The difference of about \$40,000 is accounted for in adjustments and dividends which receivers of failed banks have returned to the guaranty fund. From an abstract of the receivers' reports as of April 1, 1921, it is shown that there have been 20 failures of State banks since 1911, with deposits at date of closing of \$4,349,524. The recent failure of a large State bank will make necessary a special assessment for the benefit of the guaranty fund.

Herewith is submitted a comparative statement in relation to Nebraska State and national banks as of 1911 and 1921:

	Number	Capital	Total deposits	Aggregate assets (including rediscounts)
June 7, 1911:				
State banks.....	658	\$12,535,240	\$71,128,854	\$88,333,571
National banks	245	16,062,500	121,704,235	159,506,824
June 30, 1921:				
State banks.....	998	26,212,000	227,814,000	285,654,000
National banks.....	186	17,392,000	175,501,000	239,457,000

North Dakota.

To a request of the Comptroller for information in relation to the working of the depositors' guaranty law of the State of North Dakota, State Examiner Lofthus in a letter of date November 20, 1921, stated:

In addition to assessments already made there is a liability of each State bank for its proportionate share of losses to the depositors' guaranty fund caused by banks closed up to the time that conversion or dissolution takes place. Of course it is impossible at this time to ascertain such probable losses. It will be necessary for the depositors' guaranty fund commission to figure the maximum loss, which in no event can exceed its proportionate share of the total liabilities of the depositors' guaranty fund resulting from the closing of such banks.

No official information was submitted with respect to the number of failures of State banks in North Dakota, but from commercial and other agency reports it appears that 60 State banks in North Dakota have been closed since 1915, of which 33 were closed during the last year.

Information relative to State and National banks in North Dakota in the years 1915 and 1921 follows:

	Number	Capital	Total deposits	Aggregate assets (including rediscounts)
June 23, 1915:				
State banks.....	630	\$9,041,000	\$55,417,759	\$69,944,249
National banks.....	153	5,600,000	39,744,466	53,306,490
June 30, 1921:				
State banks.....	674	11,463,000	91,290,000	129,056,000
National banks	180	7,025,000	64,912,000	94,246,000

Washington.

The State of Washington adopted the guaranty-fund system by act of legislature of 1917, the law having been amended in 1921. The guaranty fund is created by assessments against member banks of 1 per cent of the total amount of annual average deposits, eligible to guaranty banks. Of the 300 banks of the State approximately 120 are members of the system, membership under the law being optional. The amount

of the assessments are not withdrawn from the bank, but are set aside to the credit of the guaranty-fund board and only drawn against when there has been a failure. The board advises, under date of July 6, 1921, that funds to their credit in this account on that date approximated \$700,000. It has further stated that the actual cost to members thus far has been \$28 to each \$100,000 of eligible deposits. The first payment to the contingent fund authorized at the last session of the legislature approximated \$60,000—the entire cost to the member banks thus far. The failure of the Scandinavian-American Bank in Seattle occurred recently, but no information is at command with respect to the amount of liabilities that will have to be met on account of this failure. It is learned, however, from the secretary of the depositors' guaranty fund that—

the member banks in the system are planning on a reorganization of the assets of the Scandinavian-American Bank, and if effected the guaranty fund will be relieved of this liability. If it should fail, it would mean a complete wiping out of all the guaranty fund and would mean an assessment against the various member banks for a number of years. In such a case, however, the member banks will no doubt withdraw from the system, as the law provides a method by which they can withdraw by paying all assessments, which shall not exceed one-half of 1 per cent of their average eligible deposits during a period of one year from the date of their withdrawal. It is, indeed, unfortunate that the largest bank in the system should fail, as no doubt the fund could have taken care of any other bank that might have failed.

The condition of State and national banks in the State of Washington in 1917 and 1921 is shown in the following statement:

	Number	Capital	Total deposits	Aggregate assets (including rediscounts)
June 20, 1917:				
State banks, etc.....	278	\$15,256,700	\$132,114,680	\$155,674,210
National banks.....	77	11,760,000	149,652,000	176,087,000
June 30, 1921:				
State banks.....	304	15,922,000	155,845,000	191,522,000
National banks.....	96	14,910,000	190,704,000	234,368,000

South Dakota.

The South Dakota guaranty law enacted in 1915 became effective January 1, 1916, and in a communication from Superintendent Hirning, of date of June 24, 1921, it is stated that since the law has been in operation there have been but 3 failures, the combined capital of the banks being \$50,000, and deposit liabilities \$680,000. In each case failure was due to defalcation of officials.

In a case of a failure of one bank it is stated that out of the assets and shareholders' liabilities a sufficient amount was realized to replace the amount withdrawn out of the guaranty fund and remaining assets then turned over to the stockholders, so there was no loss to the guaranty fund. In the second case liquidation has not been fully effected, but it is estimated that there will be a recovery of 75 per cent on account of the amount withdrawn from the guaranty fund. In the third case it is the judgment of the superintendent that the guaranty fund will be reimbursed to the extent of at least 80 per cent of the amount drawn to pay the depositors. A comparison of the number, etc., of the State and national banks in South Dakota in 1916 and 1921 follows:

	Number	Capital	Total deposits	Aggregate assets (including rediscounts)
June 30, 1916:				
State banks.....	498	\$8,036,400	\$72,227,354	\$85,196,801
National banks.....	124	5,260,000	52,710,000	64,602,000
June 30, 1921:				
State banks.....	566	12,927,000	136,470,000	179,201,000
National banks.....	134	6,180,000	68,671,000	96,991,000

Mississippi.

The law providing for the guaranty of deposits in State banks of Mississippi was enacted in 1914, but the banks were given until June 1, 1915, to put their affairs in such condition as to be admitted (or authorized to do business under the depositors' guaranty law) or, failing to do so, were required to go out of business.

The first failure of a bank in the system occurred in 1916, and from that date to June 30, 1921, there have been 12 failures, the aggregate capital being \$576,000, surplus and other profits \$349,894, and all other liabilities \$6,318,882. These banks had paid in to the guaranty fund the sum of \$21,000. The total receipts from the assessments on all banks up to June last aggregated \$588,933.44. From an analysis of the statements submitted it would appear that the loss to the guaranty fund over and above the amounts realized from the assets and shareholders' liabilities of nine of the failed banks would amount to over \$580,000. In one case the loss has not been determined and in the remaining two the assets of the banks were found to be sufficient to liquidate the liabilities.

From an examination of the correspondence with the banking department of the State, it would appear that 6 of the 12 failures were due to criminal acts or acts bordering on criminality, 3 to general business

conditions, and 3 due to misjudgment of the examiner. It is understood that the statement relative to the third cause relates to the reported condition of those banks at the time they entered the guaranty system.

The number, capital, etc., of State banks in Mississippi in 1916 and 1921 and the number of national banks in the State for the same years are shown in the following statement:

			Total deposits	Aggregate assets (including rediscounts)
	Number	Capital		
June 30, 1914:				
State banks, etc.....	305	\$10,893,080	\$47,684,486	\$67,147,872
National banks.....	37	3,735,000	18,115,920	27,990,020
June 30, 1921:				
State banks, etc.....	324	13,367,000	111,361,000	163,687,000
National banks.....	31	4,075,000	36,783,000	53,673,000

"The theory" (guaranty of bank deposits), states a well-known financial writer in a recent publication, "is that of insurance, but it has certain fundamental weaknesses which are more serious in their effects upon banking than in their relation to most other kinds of business to which insurance is applied. Insurance is sound as a protection against unavoidable hazards, but dangerous whenever it tends to increase the hazards. The insurance or guaranty of bank deposits tends to increase the hazards by eliminating the value of character as a banker's asset. It tends to make all banks look alike to the public, and puts the careful, conservative banker, who is unwilling to make large promises and take large chances, at a disadvantage. The theory is at fault in placing more emphasis upon the payment of depositors after a bank has failed than upon preventing failure. Its weakness always develops in a crisis."

Classifications of Loans Held by National Banks.
From the Report of the Comptroller of the Currency for 1921, p. 26.

[In thousands of dollars.]

Class.	June 30, 1919.		June 30, 1920.		June 30, 1921	
	Amount.	Per cent.	Amount.	Per cent.	Amount.	Per cent.
On demand, paper with one or more individual or firm names (not secured by collateral)	597,560	5.43	707,229	5.20	679,704	5.66
On demand, secured by stocks and bonds	1,307,787	11.88	1,261,984	9.27	1,151,114	9.59
On demand, secured by other personal securities, including merchandise, warehouse receipts, etc.	317,286	2.88	392,277	2.88	342,394	2.85
On time, paper with one or more individual or firm names (not secured by collateral)	5,251,324	47.70	7,604,971	55.87	6,564,444	54.68
On time, secured by stocks and bonds	2,130,598	19.35	1,855,906	13.64	1,548,053	12.90
On time, secured by other personal securities, including merchandise, warehouse receipts, etc.	1,014,073	9.21	1,390,122	10.21	1,320,323	11.00
Secured by real estate mortgages or other liens on realty not in accordance with section 24, Federal reserve act, as amended	90,658	.82	93,927	.69	127,171	1.06
Secured by improved real estate under authority of section 24, Federal reserve act, as amended ..	93,324	.85	135,902	1.00	153,066	1.27
Acceptances of other banks discounted	150,849	1.37	146,838	1.08	94,470	.79
Acceptances of this bank purchased or discounted ..	56,747	.51	22,260	.16	16,429	.14
Customers' liability on account of drafts paid under letters of credit and for which this bank has not been reimbursed					7,347	.06
Total	11,010,206	100.00	13,611,416	100.00	12,004,515	100.00

Suggested Readings on Chapter V.

Langston, L. H.—Practical Bank Operation.

Moulton, H. G.—Financial Organization, Chapter XXI.

Dewey, D. R., and Shugrue, M. J.—Banking and Credit, Chapters XIII and XIV.

Phillips, C. A.—Bank Credit, Chapters XII and XV.

Questions and Problems on Chapter V.

1. Some banks require a borrower to keep at least 20 per cent of his borrowings on deposit in the bank. How much would the business man keep anyway? Why does anyone keep an unused balance in the bank? Is the minimum balance which a business man needs related to the amount of borrowings or to some other magnitude in the business?

2. Discuss the proposition that the annual clean-up of loans necessarily proves that the business is not getting fixed capital from the bank.

3. What sets the limit to the amount a bank can loan?

4. From the standpoint of the borrower, what should determine the duration of the loan?

5. Should a borrower be allowed to pay his obligation before it is due, and get a rebate of the discount still unearned?

6. What effect will the tendency of discount rates to go higher or lower have on the amount of borrowing the business man will wish to do and on the duration of the paper he will offer for discount?

7. On December 1, 1920, the discount rates of the Federal Reserve Bank of New York were as follows:

Paper secured by Treasury certificates of indebtedness	5½%
Paper secured by Liberty bonds and Victory Notes	6 %
Trade acceptances	7 %
Commercial paper	7 %

Since this was a time of heavy discounting by the banks, these rates would presumably have considerable effect on the rates charged by the member banks. If you were a borrower from a member bank, in what form would you do your borrowing?

8. To what extent can a business man vary the form his loans take?

9. How much can be done to change commercial custom?

10. There are two methods of granting credit: (a) the method of looking to the goods to furnish the basis of the credit, each transaction standing by itself; (b) the method of considering primarily the credit standing of the parties liable on the credit instrument. In a time of rapid deflation, what dangers are involved in the method of granting credit on the transaction?

11. How does a depositor choose his bank?

12. Which type of deposit, demand or time, is the more profitable to the bank?
13. Pick out the type of bank which shows the greatest amount of each kind of deposit. What is the explanation?
14. Outline the various plans for guaranteeing bank deposits. Which seems to work best in practice?

CHAPTER VI.

NOTE BROKERAGE—ACCEPTANCES.

Fairly large concerns, instead of borrowing at the bank, may get funds for their business by selling notes through note brokers.

The opportunity for note brokerage arises from our form of bank organization and the seasonal character of the demand for loans in the various regions. In a system of independent banks, when banks in one region have a surplus of funds at the same time that banks in other regions have a shortage, some middleman must bring about the readjustment. The note broker sells the note of the business men in the communities where a shortage of funds exists to the banks which have a surplus of funds.

Advantages of Obtaining Funds Through Note Brokers.

1. Lower rate of interest is possible.
2. Bank may not be able to loan as much as they need.

Disadvantages.

1. In time of stringency, funds may not be obtainable.
2. Notes may not be renewable.

Advantages to Banks.

1. The risk is distributed.
2. Ordinarily the bank can count on notes being paid at maturity.

Disadvantages to Banks.

1. Rate is usually rather low.
2. No balance is kept by borrower.
3. Credit investigation is harder to make.

Acceptances.

1. The trade acceptance. The seller draws a draft on the buyer. The buyer accepts, agreeing to pay the draft at a definite time.

2. The banker's acceptance. This form is used oftener in foreign trade. It arises from the employment of a letter of credit—an instrument authorizing the seller to draw on a bank which agrees to accept the draft. The credit of the bank makes it easy to discount the bill.

Advantages of Trade Acceptance to the Seller.

1. It completes the transaction.
2. It replaces the open book account with bills receivable or cash.
3. It furnishes the basis for additional credit facilities.
4. It gets a lower rate because it is two-name paper.
5. It assures prompt payment and avoids unjustified extensions.

Advantages of Trade Acceptance to the Buyer.

1. It facilitates adjustments and settlements.

Advantages of Trade Acceptance to the Community.

1. It provides better banking paper.

Advantages of Bank Acceptance.

1. Customers get a lower rate than by the ordinary note.
2. The bank finances customer without using its own funds.
3. Acceptance furnishes good investment for banks with surplus funds.
4. Acceptance furnishes good investment for others wishing short-term investments.
5. The bank makes a commission.

Materials on Chapter VI.

Trade Acceptances—What They Are and How They Are Used, by
Robert H. Treman, Deputy Governor, Federal Reserve
Bank of New York.

*Reprinted by permission from a pamphlet issued by the American
Acceptance Council, October 1, 1919.*

To describe it simply, "A trade acceptance is a time draft drawn by the seller of merchandise on the buyer for the purchase price of the goods and accepted by the buyer, payable on a certain date, at a certain place designated on its face."

The trade acceptance system contemplates the settlement of accounts by trade acceptances, and is designed to supersede the open book account in virtually all cases wherein business is not done on a strictly cash basis.

A trade acceptance not a note.—A trade acceptance is not a sight draft or a promissory note. As one authority has explained, a note is drawn *by* a person, whereas an acceptance is drawn *on* a person. The trade acceptance performs a different function from a promissory note, as a note is generally used in borrowing money and in settlement of past due obligations, whereas a trade acceptance bears on its face evidence that it is drawn by the seller of merchandise on the purchaser for the purchase price of the goods sold, and when accepted constitutes a valid promise to pay on a specified date, and is a negotiable instrument as binding upon the acceptor as his promissory note but performs a different function from the note.

Represents current transactions only.—The trade acceptance should have nothing to do with nor be employed in any class of transactions except that concerning the purchases and sales of goods. It should not be given for borrowed money or past due accounts but should represent current transactions only.

Not a new scheme.—The trade acceptance system is not a new scheme or method, as it was used somewhat in the early history of our country. The Civil War disturbed the financial situation at that time, and the risk and uncertainty attending the granting of long credits led to the introduction of offers of large cash discounts to insure prompt settlements in cash, and gradually the open book account, with the cash discounts, came into general use.

Methods in European countries.—Business men of no other nation conduct their business as we do in the United States. In England, France and other countries, if a merchant has not sufficient cash to pay for merchandise, instead of borrowing of his bank on his own promis-

sory note, as is customary here, he gives his written obligation to the seller, or more commonly the seller draws a time draft (which we call a trade acceptance) on the buyer, and then the draft or trade acceptance is discounted at the bank. Such paper in England is known as a "bill," whereas we usually characterize it as a "draft." The large commercial banks in London and Paris hold in their portfolios large quantities of these bills, which are constantly maturing, and in case of need they indorse them to the central banks for rediscount.

In France about one-half the trade bills in circulation are in amounts not more than \$20, and out of three billion dollars of acceptances discounted in one year under pre-war conditions by the Bank of France, the average was only about \$100 and some acceptances were as low in amount as \$1, there being more than five hundred millions discounted in amounts less than \$25, thus showing the possibilities in the development of the trade acceptance system.

Canadian practice.—The trade acceptance, or trade paper, as it is technically termed in Canada, is the simple and effective credit instrument by virtue of which practically the entire internal trade of the country is transacted. It is the universal medium of settlement between buyers and sellers of goods of all description, and every wholesaler, manufacturer, jobber and retailer throughout the length and breadth of the land is conversant with trade paper and understands its efficacy in handling business.

The uses of trade paper and its intimate relation to business form part of the elementary training of every junior bank clerk; in short, trade paper is one of the fundamental and principal props of the Canadian financial structure.

It is customary in Canada for all classes of borrowers to arrange their banking credits once a year to run contemporaneously with their own fiscal year—the credits being based upon a consideration of each year's balance sheet which the bank almost invariably requires to be audited by a firm of chartered accountants. In addition to a direct line of credit (*i.e.*, one name paper), an indirect line against trade paper is also established. The direct line of credit is granted to furnish the borrower with the necessary working capital to purchase raw materials and seasonal stock in trade, the bank's policy being to stipulate for liquidation, or at least to require a reduction to a low ebb, of the direct advances at least once a year. Failure on the part of the customer to do this usually indicates the need of additional permanent capital in the business.

Technically, the amount of trade paper credit should correspond with a total approximating the proportion which the borrower's average

terms of sale bears to the annual "turnover"; for instance, if the annual turnover amounts to \$240,000 and the *average* terms of sale are two months, the trade paper credit should not exceed \$40,000—or one sixth of the annual turnover. If the trade paper under discount exceeds \$40,000 at any period, the banker is warned that the borrower has either increased the turnover in the business or that he is granting unwarranted renewals to buyers. If the turnover is heavier at one period of the year than another, the trade paper credit should fluctuate to accord with the seasonal "peak loads" in the turnover.

The manufacturer or wholesaler, fortnightly or monthly as the case may be, lodges with his banker *unaccepted* drafts drawn upon the retailers representing sales for the previous half month or month. Each bill is carefully scrutinized and may be then discounted or taken for collection. In either case it is immediately forwarded for acceptance to its destination, either to a branch of the bank or to its regular correspondent.

This procedure differs from the American system, under which drafts are not discounted until they are *accepted*—hence the term trade acceptance as distinguished from trade paper.

How to use the trade acceptance.—In general the seller when rendering an invoice for any single purchase of merchandise, if the amount is reasonably large, will accompany the invoice with a trade acceptance form duly filled out for the amount due, or, in cases where a buyer purchases of the seller (manufacturer or jobber) several bills of small amounts during the month, the seller when rendering a monthly statement will accompany the same with a trade acceptance form duly filled out for the total amount. Upon receipt the buyer has the option of either paying the bill, deducting such cash premium or discount as may be allowed, or he may "accept" the trade acceptance by writing across its face the date and the words "accepted, payable at..... Bank," and then signing and returning it to the seller, thus closing the transaction. The seller will then either retain the acceptance in his portfolio until a short time before it is due, when he will forward it for collection through his bank to the bank designated in the acceptance; or if the seller finds himself in need of funds he may, instead of borrowing from his bank on his single name promissory note, prefer to take a number of trade acceptances and discount them with his banker, or sell them in the open market through brokers or dealers in commercial paper, thus converting into available live assets the dead capital which is now practically unavailable, being tied up in open book accounts.

Attention is called to the fact that as a matter of law the place of payment of a trade acceptance is at the office of the acceptor, *i. e.*, the

buyer of the goods, unless a different place be designated on its face, such as the acceptor's bank, this being the usual method.

Responsibility of paying bank.—In forty-two of the forty-eight states which have adopted the Negotiable Instruments Act, Section 87 reads as follows:

"Where the instrument is made payable at a bank it is equivalent to an order on the bank to pay the same for the account of the principal debtor thereon."

In Missouri this provision is qualified by the addition of the following words:

"— but where the instrument is made payable at a fixed or determinable future time, the order to the bank is limited to the day of maturity only."

Illinois, Nebraska and South Dakota omit the provision entirely; so also does Kansas, which repealed the section by Chapter 94 of the laws of 1915.

In Minnesota the word "not" was interpolated so that the section reads—"shall *not* be equivalent," etc.

Georgia is the only state in the Union which has not up to this time (October 1, 1919) adopted the Negotiable Instruments Act.

Collection of trade acceptances.—Banking institutions receiving trade acceptances for collection either through deposit by customers or otherwise should collect them through the usual collection channels. When made payable at a banking institution they must be presented there for payment. Failure to present them for payment at maturity at the banking institution where they are payable is to disregard the lawful obligation of the collecting agent and is contrary to good banking practice.

No special inducements necessary.—The giving and taking of trade acceptances should not as a rule be used as an excuse for granting special terms. If a concern is receiving trade acceptances from its customers, such acceptances will be available for obtaining funds to meet acceptances it may have given. Unwarranted inducements in the form of additional time and extra discounts given in order to convert accounts into the form of trade acceptances will tend to cheapen the character of acceptances thus made. Special terms which include conditions noted on the trade acceptance will prevent or hinder the free negotiation of such bills.

A corporation which has had experience in the use of the trade acceptance system says: "Except where unusual circumstances have existed, we have not found it necessary to offer any special inducement to obtain acceptances from our customers. Such cases have been rare and the

maximum concession has been a few days' extra time. In no case have we allowed any extra discount and it has been rarely requested." This seems to prove that the buyer understands that by accepting he will be benefited in other ways.

It is important to remember here that Federal Reserve banks may purchase trade acceptances in the "open market" whereas they cannot purchase notes, no matter how strongly they be drawn and indorsed, and that "open market" rates are generally below the discount rates of all central banks in Europe and of the Federal Reserve banks in the United States.

What constitutes the open market.—An explanation of the "open market" seems proper to insert here: The "open market" is not a particular space set aside for the transaction of business, but is rather that section of a financial district in which are located the banks, brokers, dealers, accepting and discount houses, who together with their clients wherever located constitute the "open market," in which bankers acceptances, trade acceptances, and other prime commercial instruments are bought and sold.

Dealings in commercial paper in the open market in the United States have long been confined chiefly to the sale of single name promissory notes, which, once having been purchased by a bank, were rarely, if ever, resold. Such paper is seldom purchased by other than financial institutions, whereas in Europe many merchants make temporary investment of idle funds in accepted bills, both trade bills and bankers acceptances. The open market there affords a medium for the ready purchase or sale of such paper. It has been authoritatively estimated that the volume of paper revolving and circulating in the open market in London before the recent war was normally from \$1,500,000,000 to \$2,000,000,000. The rates that obtain in such markets are ordinarily stable, and for prime paper average somewhat below the discount rates. The great commercial advantages accruing to any country that can maintain a stable free and open market must be apparent to every user of credit, as to such a market are attracted the idle funds of the world.

The market in New York.—A market similar to the London market is in process of establishment in New York. In the open market in New York already are circulating very considerable amounts of prime bankers acceptances and "dollar" bills of exchange drawn in foreign countries on American importers and accepted by them. The volume of such paper is constantly increasing, and the ready sale that it finds in the New York market has aided materially the position of "dollar exchange" in foreign markets, so that now the United States is largely financing its own imports, as well as large amounts of exports of

American goods to foreign countries and the movement of goods between foreign countries. Our open market requires both for its immediate and ultimate development a greatly increased volume of prime paper that will find sale through the market in and out of the portfolios of banks, banking institutions, merchants, and other investors, and which may be discounted by or sold to Federal reserve banks. Trade acceptances, well drawn and with strong acceptors and with the accumulated strength of subsequent indorsers, constitute ideal paper for such market. The volume that would be created by the general adoption by our leading merchants of the trade acceptance plan would doubtless be sufficient to make our open market pre-eminent, and would attract to that market the brains, ability and capital required for its full and successful development.

Acceptances as defined by the Federal Reserve Board.—A trade acceptance is defined by the Federal Reserve Board in Regulation A, Series of 1917, as a draft or bill of exchange drawn by the seller on the purchaser of goods sold, and accepted by such purchaser; and a bill of exchange, within the meaning of this regulation, is defined as an unconditional order in writing, addressed by one person to another, other than a banker, signed by the person giving it, requiring the person to whom it is addressed to pay, in the United States, at a fixed or determinable future time, a sum certain in dollars to the order of a specified person.

The word "goods" as used in the above regulation is construed to include goods wares, merchandise or agricultural products, including live stock.

Eligibility.—To be eligible for purchase by or discount at a Federal reserve bank, a trade acceptance should present *prima facie* evidence that it is drawn by the seller on the purchase of goods sold and must have a maturity at time of purchase or discount of not more than 90 days, exclusive of days of grace, excepting that if drawn for agricultural purposes or against sale of live stock, it may have a maturity at time of discount of not more than six months, exclusive of days of grace.

Bankers acceptances.—Having defined a "trade acceptance," it may be well here to define a "bankers acceptance," as apparently there is some confusion as to the two kinds of acceptances and how they are used.

The Federal Reserve Board has defined a "bankers acceptance" as "a draft or bill of exchange of which the acceptor is a bank or trust company, or a firm, person, company or corporation engaged in the business of granting bankers acceptance credits," arrangement having been made with the bank or other party to "accept," thus lending its credit, for which satisfactory security is given and a commission paid.

The "bankers acceptance" will be used in the handling of commod-

ities, such as grain, cotton, copper, etc., and in other large transactions, but its use in financing ordinary domestic commercial transactions between buyer and seller will be limited and comparatively infrequent as compared with the trade acceptance, and the consideration of its use, therefore, is not attempted here.

Why use the trade acceptance instead of the open book account? The ever-increasing demands upon the United States for credit to finance not only our growing domestic trade but also Europe's needs during reconstruction and a larger proportion of international trade make it essential that by every proper means we conserve our resources to meet these, our new obligations to the world. The trade acceptance method of settling commercial accounts can be made an important factor in conservation of credit. It is credit thrift in practice. Its use will assist in releasing credit not otherwise available.

A statement of principles.—Paul M. Warburg, speaking for the American Acceptance Council, has said: "We are preaching the gospel of the trade acceptance for no other purpose than that we believe its use makes for sounder business and banking conditions.

"We do not say that the trade acceptance system serves all purposes and that all cash sales and all cash discounts ought to be avoided; but we do say that where business is not done on a strictly cash basis, the trade acceptance will be found the safer, sounder, and, in the long run, more economical method than the open accounts.

"Indeed, we believe that it is so much of an improvement over the open account that in some cases sellers, at present sacrificing a very heavy cash discount for the purpose of avoiding the dangers and inconveniences of open accounts, might find it to their advantage to consider the economy involved in the use of the trade acceptance when dealing with customers of strong credit.

"We do not want to appear as wishing to force upon anybody the adoption of the trade acceptance, unless he considers it as serving his better interest. We do wish, however, those who can profit from the method to study it carefully and not to hesitate to adopt it.

"The American Acceptance Council's interest in the matter is that whatever makes for better morals in business and for better credit and banking conditions is a decided benefit to the United States."

A system in tune with movements of business.—The National Association of Credit Men says: "The framers of the Federal Reserve Act had in mind that we must have a banking system that would be in tune with the movements of business in its expansion and contraction and to this end we must get our banks away from investment banking and make of them 'business banks.'

"This was accomplished by giving paper arising out of actual business transactions a preferential position as a safe banking investment. Business paper in this respect has changed places with instruments backed by investment collateral, such as bonds, etc., which formerly stood next to cash as the banker's reliance against periods when money became tight.

"And so we find the merchant's and manufacturer's credit instruments coming forward as the result of the enactment of the Federal Reserve System, and that form which of all credit instruments most closely represents business transactions—the acceptance, whether bank or trade acceptance—is that which is preferred over all others as a basis for credit extension, whether for discount or for rediscount with the Federal reserve banks. The acceptance, therefore, is the second line of defense in our banking system, the best assurance against panic, and it is up to the business men of the country to do their part to build up and strengthen this line and make possible to the fullest degree the establishment of a thoroughly scientific banking system."

A recent writer says: "Just as we should insist upon the essentially democratic doctrine of universal military training to protect the rights of our people, so should we insist upon the employment of sound and economical methods to protect the resources of our country and our commercial interests."

Credit immediately available.—The credit represented by "open book accounts" is credit which remains tied up and practically unavailable (so long as it continues in that form) until liquidated at or after maturity; whereas, by converting the open book account into a trade acceptance the credit represented by the account becomes immediately available for additional use by the seller, because the trade acceptance is readily rediscountable with banks and the owner can secure the proceeds for reinvestment, thus keeping at work the amount of capital represented by the account.

Present custom.—Desiring to ascertain to what extent the terms of payment agreed upon are lived up to, under the present open book account system, the writer made a recent canvass among manufacturers and jobbers of one line (hardware), with the following results: Among manufacturers the terms are usually 60 days, less 2 per cent premium for cash in 10 days. The reports show that when the bills are discounted, instead of being paid in 10 days, they have averaged 15 days, and for those who take the option of the 60-day credit period, the average payment is in from 75 to 80 days, and 10 per cent or more of customers take 90 days or more.

As to jobbers (wholesale distributors), the reports show that through-

out the country generally from 40 to 50 per cent of buyers discount their bills within 15 days after purchase, while of those who take the 60-day option from 25 to 30 per cent pay "promptly," or within one month following the 60-day maturity. Of the remaining 20 per cent, only about one-half pay in the period between three and four months after purchase while the other half pay in from four to six months, or never, notwithstanding that the terms of sale agreed upon were for a credit of only 60 days.

Defects in present custom.—Though manufacturers and merchants have become so accustomed to their present credit methods that many believe these cannot be bettered, the fact remains that there are serious defects in the present methods which should be and can be corrected.

Beverly D. Harris, Vice-President of the National City Bank of New York, recently said: "For more than half a century the American people have labored under a banking system and a commercial credit system amazingly crude and inefficient, and they have clung tenaciously to habits of ancient origin. Their progress toward the scientific and enlightened standards of European countries has been painfully slow. The time has come for a reform in the credit system of this country, and we have now arrived at an epoch so momentous that the need for advanced constructive measures is apparent. The enactment of the Federal Reserve Law was a long step forward in the correction of our deficient and crude banking system and it has opened the way for modernizing our credit system."

Converting sound assets into means of payment.—Dr. H. Parker Willis, formerly Secretary of the Federal Reserve Board, has said: "The Federal Reserve Act is a measure intended to improve business conditions, lay the foundation for more efficient service, render credit uniform in its distribution among borrowers of equal merit . . . reduce the cost of every service by rendering sound assets more readily convertible into immediate means of payment. . . ."

Lewis E. Pierson, Chairman, Irving National Bank, New York, says: "The trade acceptance is the logical method of conducting the class of business transactions based upon credit. It carries on its face the evidence of efficiency, economy and security. The trade acceptance means more to the future of American commerce than we can realize at present."

Credits should receive more attention.—The subject of credits in our financial life should be given more attention. In our commercial transactions all the terms and details are generally definitely expressed and understood and based on sound business experience except only the credit arrangement. Under the present methods credits are placed in

open book accounts, the date of payment of which, while understood and definitely stated, is left wide open and in many cases the date of payment is postponed and ignored.

The open book account has made the cost of distribution from manufacturer to consumer unnecessarily expensive, because of extra office work entailed, with its losses of interest on overdue accounts, of waste and loss from bad debts.

Loss of seller's profit.—When a buyer fails to pay his bills at a specified time he is forcing the seller to carry the account on his own capital with no compensation for this in the selling price of the article sold. Each day that passes after maturity means a shaving down of the seller's profit. "A generous credit granting in this country has dulled commercial men regarding the importance of meeting obligations promptly." It is well for the business man in considering the value of the trade acceptance in its relation to his own business to bear in mind the bigger and broader view and not to limit his horizon to his own affairs.

The signing of a trade acceptance by the buyer is no different in its moral effect than the signing of the order specifying the kind and quality of the goods. In signing an order, whether by letter or otherwise, the buyer obligates himself to purchase the quality and quantity of the goods specified, the date of shipment and all the other details; and in signing the trade acceptance he simply confirms the agreement as to the terms of payment.

W. F. H. Koelsch, President of the New Netherlands Bank of New York and formerly President of the New York Credit Men's Association, said in speaking of trade acceptances and better business: "The general proposition of the trade acceptance is characterized principally by its simplicity. It is strange that the great economic value and the timeliness of this movement have not been more readily recognized by business men generally, and bankers in particular.

Better business methods essential.—The trade acceptance is a form of commercial paper the use of which will do more to increase American financial efficiency than almost any other factor, whereas the open book account system is wasteful and inefficient. Competition has in the last few years been extensive and seems to be growing, leading often to unsound business methods, while the cost of doing business continues to mount; all of which emphasizes the necessity for better business methods and more careful consideration and less waste.

Increasing efficiency.—Besides, we are now living in the midst of most unusual conditions caused by the war and too great emphasis cannot be laid on the importance to manufacturer and distributor during this period of a proper study and analysis of their own business methods

to make them more efficient and economical and to put themselves in a position to meet the competition and changed business conditions which are undoubtedly developing in the post-war period. Nothing will assure this more than improvements in our methods of extending credit.

Capital requirements reduced.—Elimination of open book accounts and substituting therefor trade acceptances would reduce the necessity for an excessive amount of capital in use by manufacturer and jobber and would save the interest on a large proportion of the credits outstanding now in the shape of book accounts, as the trade acceptance can be discounted at the bank and, therefore, necessity of furnishing the credit would fall upon the banker whose function it is to supply and sell credit, rather than upon the merchant or manufacturer.

It is difficult, in a period when credit can be easily secured at moderate rates and banks are seeking loans, properly to appreciate the importance of providing ways and means for making credit more easily available at reasonable rates when we later on may have entered a period of restricted and contracted credits with possibly higher rates for loans.

Safe to use.—It is much safer to sell on longer time with acceptance than to sell on so-called short time with open accounts, the date of payment of which is most uncertain. This is the only country in the world where sellers of goods finance buyers by borrowing money themselves to extend indefinite credit to the buyer.

The trade acceptance offers tangible benefits to practically all branches of business and the conditions never were more favorable and propitious for their introduction than at present.

Credit resources strengthened.—If the amount of this country's internal annual commerce could be known, some idea could be given of the amount of real commercial paper which could be based upon such a tremendous volume of transactions. If the big credits or open book accounts of the country were converted into trade acceptances, it would make an enormous total and this credit in negotiable form would greatly strengthen the credit resources of the country.

More business on same capital.—It is estimated that from two to three times the volume of business can be done on the same capital by the use of trade acceptances instead of open book accounts and that it can be done safely and conservatively, all of which should tend materially to lower the cost of doing business, to assure reasonable dividends on capital and to lessen the high cost of living.

It is important that the retailers should give the trade acceptance in settlement with the wholesaler and in turn the wholesaler may dispose of them to the banker who can rediscount them with the Federal Reserve banks, thus furnishing to them eligible paper.

Selling terms.—It is to be hoped that soon the selling terms in many lines will be:

(1) If cash is received by the seller within — days, a discount or premium of — per cent will be allowed.

(2) If credit is given and accepted, settlement is to be by trade acceptance, maturing in — days. No open book accounts.

Advantages to the Buyer.

Those who settle by trade acceptance will put themselves into a class of preferred buyers the same as those who discount for cash as against those who, declining to use trade acceptances, insist upon a long open book account. This fact will be recognized by the mercantile agencies in their ratings and with the inevitable result that goods will be sold to those who demand long credit only on the basis of their paying higher prices than those who discount, or use trade acceptances.

Check on overbuying.—Their use will be a check on overbuying as the buyer's ability promptly to meet his obligations when they come due will tend to control the volume of his purchases. The retailer using a trade acceptance will have a better standing if called upon to make a statement, especially with bankers, because "acceptances payable," are more favorably regarded than "accounts payable."

Giving trade acceptances strengthens credit standing.—Those who pay bills promptly taking the cash discount, or premium, are not expected to use the trade acceptance to a great extent, but as all retailers should buy at the best possible prices, those who do not discount should give trade acceptances to strengthen their credit standing, so as to purchase on terms which will enable them to compete successfully with mail-order houses, five and ten cent stores and others who buy and sell strictly for cash.

The retailer should be more careful in the extension of credit to his own customers, should insist upon shorter credits, and require payment of them when the debt becomes due. The practice of allowing customers to extend the credit much beyond the time originally agreed upon serves to tie up capital and often keeps the retailer from being prompt in his own payments and therefore results in an economic loss.

Among our national business vices are those of trying to do business on inadequate capital and giving too long credit.

The buyer, *i.e.*, retailer, by giving trade acceptances, will not find it necessary to hypothecate or sell his accounts receivable, as some do, at a sacrifice because of the high cost of such transactions.

Book accounts not readily convertible into cash.—Book accounts may be of high grade and absolutely good but they are not readily

convertible into cash. The sale and distribution of merchandise is a most important part of our business system and the accounts created thereby should be liquid and not tied up. To reduce costs, to inaugurate economies, to make more efficient business methods are for public good—and the retailer, by giving trade acceptances, relieves the seller—that is, the manufacturer or jobber—from the burden of acting as his banker, a service which the seller has been practically forced into rendering and at considerable expense for the necessary capital.

Long extended credit in open book account an economic waste. The retailer, finding it easy to secure long time credit, not realizing that he is paying dearly in prices of goods for this credit, falls easily into the habit of extending unreasonable lines of credit to his own customers, thus in turn training them to have no definite time for payment. These long-extended credits means slow collections, bad debts and great economic waste. This practice puts a burden on the retailer of limited capital whereas by using the trade acceptance with those from whom he buys the retailer in some lines can also inaugurate the same system with his own customers, especially on sales of fairly large amounts, thus putting his own accounts into paper which can be used with his banker. The use of the trade acceptance will make better merchants, more conservative and less dangerous to their competitors who derive a limited reasonable profit from their sales.

The retailer will have a stronger sense of responsibility toward his obligations if he agrees to definite periods of payment and, knowing the exact dates the trade acceptance becomes due he can arrange to meet these obligations.

The buyer should not hesitate to give a trade acceptance in payment of an honest debt, as he assists the seller the same as if he pays cash and he can feel that in this way he is "doing his bit" in making the nation's credit position sounder.

Advantages of trade acceptances.—The use of the trade acceptance establishes quickly the correctness of the account as between buyer and seller, obviates the tendency to friction over differences, not reported until the account is due, reduces the expense of collection and lessens the cost of conducting business. To carry on the open book account system, sellers strain their own credit in order to extend credit to the buyer for an indefinite time, frequently without interest, security or even any evidence of the sale, a custom which often results in loss by nonpayment of the account.

The buyer should be willing to give the seller a trade acceptance which is a negotiable acknowledgment of the debt no less readily and

with no more hesitation than he would give his banker a promissory note for money loaned to him by the bank.

Retailer's competitive power increased.—The use of the trade acceptance will put the smaller retailers, especially those with limited capital, in a better position to compete with those who have larger capital. The trade acceptance is scientific and will work a great improvement in our whole merchandising system and tend to make the untrained and unsystematic tradesman of less menace to his competitor who does business on sound methods.

Many a retailer who has difficulty in securing sufficient capital depends upon competing jobbers to extend him long credits for which he pays by higher prices, whereas by making a few changes in his business methods, using the trade acceptance with his own trade, his cash resources can be materially improved and in many cases the trade acceptances given to him by his own customers could be turned over to the jobber or manufacturer from whom he buys.

Easy to use.—There is no more difficulty in using the trade acceptance than in using the so-called farmers' notes or lien notes. Business would be much bettered if the methods of taking notes for long periods were abolished and the trade acceptance substituted also by turning over to the banker the loans which many of the merchants have themselves been making to their customers. If notes are used they should bear interest.

Under the open book account the conditions as to credit are undefined and uncertain, whereas by the use of the trade acceptance, credits would be defined and certain, and thus there is provided the most approved and economic method of transacting business.

Bookkeeping made simpler.—The use of the trade acceptance will tend to simplify bookkeeping and will obviate the need of long book accounts and borrowing to enable the retailer to extend long credits to his customers.

More desirable paper.—Trade acceptances are what bankers call two name paper, *i.e.*, drawer and acceptor, and as such are considered more desirable paper for bank investment than single name paper, *i.e.*, promissory note with no indorser.

The national banks are limited by law from loaning to any one person or firm more than 10 per cent of the bank's own capital and surplus, but the bank is not subjected to this limitation in buying trade acceptances.

No limitations in buying.—Section 5200, Revised Statute U. S. (National Bank Act), exempts from the limitations of the Act "the discount of bills of exchange drawn in good faith against actual existing values and the discount of commercial or business paper actually

owned by the person negotiating the same," and it is understood that a bill may be considered as drawn against existing values if drawn against the drawee at the time of or within a reasonable time after the shipment or delivery of the goods sold. It is not customary, however, to regard as drawn against actual existing values bills which have been extended or renewed, but only bills arising out of current transactions; therefore, a renewal bill drawn in the guise of a trade acceptance would rightfully be considered a subterfuge and should not be drawn.

Buyer using acceptances establishes his credit.—The buyer using trade acceptances will reduce to a great extent the advantage formerly held by the cash discount buyer as the seller will have more confidence in the buyer's ability to pay if the buyer is willing to give a definite promise as to time of payment.

If the buyer meets his trade acceptances when they mature he will establish and confirm his credit, and should he on occasion wish to postpone date of payment of the trade acceptance, he should be able to secure an extension of credit by giving a promissory note with interest.

Puts credit on safer and sounder basis.—Buyers, knowing that their obligations will mature at a certain definite time and in many cases will be discounted at a bank, thus putting their credit to the test, would realize the necessity of meeting their obligations when they come due, would be more prudent in selling on long credit, more careful to abstain from overstocking, watch closer their collections and be more apt to pay their own debts promptly; thus the credits of the entire country would be placed on a safer and sounder basis.

"They tend to enhance and extend rather than reflect on the acceptor's credit. Trade acceptances will only be offered to buyers of approved credit and standing because the seller's own standing will be reflected in the character of acceptances offered to his bank."

To the buyer who generally takes advantage of the cash premium or discount, the trade acceptance will be found of advantage occasionally in dull times, as the seller will be willing to receive a trade acceptance because of its availability for discount should he need funds.

By giving a trade acceptance the buyer "assumes no obligation until after the seller has relinquished title to merchandise of equal value to the amount represented by the trade acceptance" but the buyer binds himself to do no more than he expressly promised to do when he made the purchase, that is, to pay for the goods when the bill is due.

How to finance one's business.—"With the curtailing of credits and the shortening of selling terms in practically all lines, the question of how the retailer will finance himself is a most important one and by making a few simple changes in his business methods he can increase

his cash resources materially. We recommend that our dealers cooperate for better business by urging the use of trade acceptances upon travelers, dealers and country banks." (Extract from recommendation of the National Implement and Vehicle Association.)

Advantages to Seller.

By substituting the trade acceptance system for the open book account the seller is benefited in the following ways:

Capital made liquid.—Liquid commercial paper is substituted for the open book accounts, the capital for which is tied up until maturity and generally longer. The making liquid and available to the seller the amount represented by open book accounts helps the credit position of the country materially by increasing the credit resources to that extent. The trade acceptance system would practically eliminate overdue accounts which, according to records obtained from jobbers and manufacturers, amount to about 30 per cent of the sales, and if legal proceedings are necessary a trade acceptance is much better than an open book account because the seller has an acknowledgment in writing of the correctness of the account.

The use of the trade acceptance would remove the necessity for the manufacturer or jobber, with somewhat limited capital, borrowing so heavily in order to act as banker in supplying credit to customers, as is now done to such an unreasonable extent, and a broader market would be opened for his paper at most favorable rates.

Loss by bad debts reduced.—The trade acceptance, in effecting prompt payments, would reduce loss by bad debts and would save the interest on overdue accounts.

Trade acceptances would curtail or end the bad practice of taking unearned or unauthorized discounts, would curb the unfair practice of returning merchandise after shipment has been made, would tend to stop the pernicious practice of assigning or hypothecating book accounts to secure working capital, and would operate to reduce the overhead costs of doing business and enable both manufacturer and jobber to sell at lower prices.

The Federal Reserve Board, recognizing the advantages of the trade acceptance, has authorized special, low rates of discount for this class of paper, and all Federal Reserve banks in establishing rates have made a rate generally $\frac{1}{4}$ to $\frac{1}{2}$ of 1 per cent lower for trade acceptances than the rate for promissory notes.

Friction between buyer and seller reduced.—The friction between buyer and seller will be reduced and the return of goods without

authority or justification like other abuses will be eliminated to a great extent.

The seller will have paper more acceptable to his bank for discount than when he offers his single name paper; even if he does not need to rediscount at certain periods of the year, he can always feel that he is fortified against emergencies or sudden business depression or crisis by having in his safe, instead of "accounts receivable" (which may be "frozen" assets), acceptances which can be discounted easily and immediately to raise the necessary funds at fair rates.

Less loss and fewer failures.—"Unquestionably, if merchants were more careful in extending credits to customers, there would be much less loss and fewer failures." Too often wholesalers extend unreasonable lines of credit to a certain class of retail merchants who, having but little capital themselves, operate principally on the credit extended to them by rival firms, thus educating the retail merchant in turn to overextension of credit with his own customers, which means slow collections and bad debts and in many cases the requirement to be carried over from one year to another in case of poor crops, or because of dull seasons from other causes.

Too many sellers strain their credit to sell goods to buyers for an indefinite time without interest, without security, without evidence of the sale and much too often without payment.

Evidence of completed transactions.—A trade acceptance evidences a completed simple commercial transaction, and the buyer need not wait to accept until his goods are received. The seller can accompany the acceptance with a bill of lading or shipping receipt if it is desired, and the transportation company is responsible for delivery. Any difference of claims arising about the shipment can easily be adjusted later.

Many sellers of limited capital have too much of their capital and money borrowed, tied up in open book accounts, and it often operates to limit the amount of business which they can do; whereas, by using the trade acceptance which the banks would gladly purchase, the seller makes a quick turnover of his capital, secures an early return to him of his profit and expenses connected with each transaction and has his capital available for increasing his business.

Helps to predetermine receipts.—It is recognized that there is a class of buyers, fortunately not large however, from whom it is desirable to obtain binding obligations to pay in accordance with agreement.

The use of trade acceptances enables a house to determine with some degree of definiteness what its income will be from week to week, and is much more satisfactory, avoiding the disappointment which quite often occurs when a house which usually pays promptly does not do so. The

trade acceptance matures at a fixed date and payment can usually be depended upon.

Education necessary; one way to develop it.—Education is required in every evolution from old and outgrown methods to more modern and better ones, and as the purpose of the change from the open book account system to the use of trade acceptances is not as yet generally understood it is suggested that the traveling salesmen of each house should be thoroughly instructed as to the advantages of the trade acceptance system and they will be most helpful in securing the co-operation of the customers of the house. It is simple, easily understood and can be adopted at any time. Some houses, to introduce trade acceptances, find they can reasonably grant slight concessions in their terms.

Advantages to the Consumer

The general adoption of the trade acceptance system by the commercial community would benefit the consumer as follows:

(1) By materially reducing the losses of interest and bad debts, the cost of doing business would be correspondingly lessened and the high cost of living would be reduced.

(2) Trade acceptances being the best and most liquid form of a bank's assets, the general use of them and their purchase by banks would make the bank's investments sounder and the banking position stronger. Everything which tends to make the bank position strong tends to benefit the entire community.

(3) Trade acceptances make for lower rates of interest, as they can be rediscounted at Federal Reserve banks at a lower rate than any other form of merchants' paper and they therefore permit more economical distribution of merchandise and food products.

(4) As the seller who uses trade acceptances can employ his capital to better advantage and make it do nearly double the work possible under the open book account system, with slight additional risk and with more frequent turnover, his business has a smaller operating cost.

(5) Whatever losses may occur under the open book account the public in the last analysis has to assume through the price of goods, and any improvement in business and credit methods which can be installed tending to reduce this loss cannot but be of benefit to the public, *i.e.*, the consumer.

(6) If large corporations with high credit which finance their needs by borrowing from banks on their single name paper or by securing additional money by issuing bonds would adopt the trade acceptance system and arrange with their customers who also are, as a rule, of high credit,

to accept trade acceptances, they would secure their additional capital at a lower rate of interest because such acceptances would find a ready market, and because of the investment capital thereby released, and if the corporations secure their working capital at a lower rate it should assist them in making lower prices to the consumer.

Advantages to the Banker.

The use of trade acceptances makes it possible for banks to finance legitimate business transactions with greater safety and convenience.

Trade acceptance a most liquid investment.—"Banking experience for many years has demonstrated that purely commercial loans are the safest of all temporary investments." The two name commercial credit, that is, trade acceptance, is one of the most liquid and satisfactory forms. The credit represented by a trade acceptance with two or more names gives evidence that the buyer is prepared to meet his obligation at a certain definite time and is adopting the most approved and economical way of transacting business.

It is a fact that "under the banking systems of no other country in the world where credit forms a basis of currency is single name paper acceptable to banks of issue, while on the other hand two name, self-liquidating trade paper is universally required, and the Bank of France requires at least three names."

More acceptable form of investment.—In lending on single name paper the banker is loaning really against mixed security, *i.e.*, goods already sold (represented by accounts or bills receivable) and goods in stock not yet sold, also plant and good will are thought of as back of it; and, therefore, the trade acceptance is a more acceptable form of investment, as it represents sales actually made and carries two names instead of one as security.

Banks could better purchase trade acceptances which are based on definite transactions, the details of which can be easily ascertained, than commercial paper which is offered in the open market and about which they often have limited knowledge.

It is generally recognized that the best investment of a bank's resources is in the purchase of paper representing sales of commodities or merchandise actually made, payment for which is to be made in the future, and as a basic proposition such paper is entitled to a lower rate of discount than a loan based on raw materials or merchandise not yet sold, which may be destroyed or affected by age, or remain unsold.

Added security.—The bank which purchases a trade acceptance instead of single name paper of its depositor has the security upon which the single name paper would be based and also the added security repre-

sented by the name of the acceptor, and from systematically buying trade acceptances will form a very good judgment as to both the maker's and acceptor's credit standing and will have better knowledge of a borrower's financial position.

Advantages in using trade acceptances.—Many state banks and, under Section 5200 of the National Bank Act, all national banks are limited in their loans to any single borrower to 10 per cent of their capital and surplus, which in many cases obliges the large borrower to go outside of his own city for part of his loans, thus preventing his local bank from using funds in what, in many cases, would be most desirable loans. This, however, could be overcome if the borrower held trade acceptances of his customers, because his bank could discount these without regard to the 10 per cent limitation, under the terms of the statute, which provides that the discount of "bills of exchange drawn in good faith against actually existing values, and the discount of commercial or business paper actually owned by the person negotiating the sale" shall not be considered as money borrowed, and this procedure would also have the advantage of leaving the bank with a class of paper which it could in turn rediscount with its Federal Reserve bank without regard to the further limitation contained in Section 13 of the Federal Reserve Act.

Of benefit to local community.—Where banking facilities are limited, local manufacturers and jobbers have sometimes been restricted in the development of their business either by inability to secure sufficient working capital, or in some cases by the high rates of interest exacted by the local banks, and the use of trade acceptances, while enabling the banks to employ their resources safely, would permit them to encourage the local manufacturers and jobbers in the safe and reasonable expansion of their business, thus directly aiding in the development of the business of their locality.

It is admitted by bankers that if the trade acceptance plan is adopted, there will be a tendency among banks toward making a somewhat lower rate when they purchase or discount these acceptances than they now do in the purchase of single name paper; but admitting that banks may have to loan on acceptances at lower rates than on single name paper, their net earnings should in the end be larger, or at least more regular and more to be depended upon, with less loss.

Bankers should encourage their use.—Those banks which are striving to better serve their commercial depositors should certainly encourage the use of trade acceptances, as their use gives a banker a line on his customers as to whether the people to whom the customers sell promptly and also whether they pay their own bills promptly.

An experienced credit man says: "No method of analyzing credit now available is so conclusive as to the commercial character of any desired loan as the evidence presented by a trade acceptance. Every element of doubt, except the possibility of actual fraud, is removed."

Easier to determine credit standing.—"From the credit man's point of view it will make it very much simpler and easier definitely to interpret a financial statement of a buyer seeking credit, as against the more or less indefinite item of 'accounts receivable' in a balance against which a fair percentage of depreciation must be applied; any item represented by a trade acceptance will represent something infinitely more tangible on which the credit man can base credit. From the point of view of the man seeking credit, it will enable the seller to grant him credit more readily, and more of it."

Would create more business for banks.—Trade acceptances would create a larger volume of bankable paper and a larger volume of business for the banker as well as for the business man, which, without a doubt, would produce for the bank increased rather than decreased earnings. The main advantage to bankers is not primarily a selfish one, however, but improvement in the whole structure of credit.

The Guaranty Trust Company of New York has said: "American business men and bankers are rapidly increasing the use of this valuable instrument for financing trade, which is simply the buyer's acknowledgment of the correctness of an invoice with the agreement to pay for the goods at a stated time. The use of the acceptance strengthens the credit of the buyer, enables him to buy to better advantage, systematizes his purchases and payments. For the seller, it reduces the burden and loss of the complicated and unproven open account. To the bank, it provides approved commercial paper. It turns the buyer's credit and the seller's wares into immediate money."

Desirable bank asset.—The average small bank, and even large ones, located in the interior are not in many cases as liquid as they really should be. They carry too many slow loans and there appears to be a lack of appreciation of the value of accumulating larger quantities of self-liquidating paper. The practice of repeatedly renewing loans has caused unfavorable comment. While under the Federal Reserve System member banks possess better facilities for ready conversion of assets through the use of the rediscounting privilege, still the individual banks should realize the necessity of following a policy of self-reliance which can be done best by having on hand ample supplies of commercial paper eligible for rediscount with the Federal Reserve banks, and trade acceptances represent just such desirable assets.

While the Federal Reserve bank is not permitted to discount a trade

acceptance having a maturity longer than 90 days, unless given for agricultural purposes or based on live stock, in which cases the eligible maturity may not be more than six months, yet a member bank can discount a trade acceptance of long maturity, given for merchandise, and carry it until it comes within the 90-day period, when it can be discounted at the Federal Reserve bank.

D. C. Wills, Chairman, Federal Reserve Bank of Cleveland, says: "Trade acceptances automatically furnish that highest class of credit data, namely, accurate information, enabling bankers to estimate more intelligently the responsibility of their borrowers. A high-grade trade acceptance will find a wide market.

"Every time a trade acceptance is substituted for a promissory note based on the mixed and undefined credit of the maker or for a book credit of still more ambiguous character, a step has been taken toward the ideal of sound trade credit."

Credit structure modernized.—By encouraging the use of and purchasing trade acceptances which in turn can be used as a basis for note issues by the Federal Reserve banks, the banker is assisting in the modernizing of our credit structure.

The banker should be progressive, alert to encourage every movement tending to bring about the soundest and most scientific credit situation. The manufacturer, jobber and retailer all seek advice from the banker on financial matters and on such changes in business methods as that represented by the substitution of the trade acceptance for the "book account," so that there is a responsibility resting upon the banker, which he should not shirk, to do his part in introducing and developing the use of the trade acceptance and an "open market" for the sale of acceptances.

The banker's duty.—Unfortunately up to the present time the bankers have not done their part in this connection. Whether this is due to lack of appreciation of the benefits which would accrue to the country by the adoption of the trade acceptance system or from a lack of knowledge of the details connected therewith or from a dislike to adopt changes, or whatever the reasons, the fact is that there is frequent testimony from jobbers and manufacturers alike that their bankers have not encouraged them to adopt the trade acceptance system.

This can only be explained on the ground that many bankers have not properly investigated the merits of trade acceptances and when they do make such a study they not only will be convinced of the great advantages but will co-operate in the movement to make the use of trade acceptances general.

Acceptances in Our Domestic and International Commerce, by
Paul M. Warburg, Chairman Executive Committee,
American Acceptance Council.

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This is the third time you have honored me with an invitation to address a Credit Men's convention, and genuine, indeed, is my appreciation of your generous willingness to listen to me again. All the greater, however, has been my embarrassment to write for you a new variation to the same old song, and to find a tune that would not sound stale to such patient friends.

Barely a year ago it was my privilege to speak to you at Chicago on the topic of trade acceptances, in the educational propaganda for which, from the inception of the movement, your Association had taken a leading part. Since then the Trade Acceptance Council has enlarged its name and scope into the "American Acceptance Council" whose widened field of activity now also embraces the "bankers acceptance." This was a natural evolution and followed as the logical consequence of our country's increasing interest in world trade and world finance. The trade acceptance, in its most important aspects, relates to our domestic business; the bankers acceptance renders its primary service in financing foreign trade. What could have been more timely, therefore, than for the Trade Acceptance Council to adjust its gait so as to keep step with Uncle Sam's rapid strides into foreign fields?

I need not assure you that this new departure could not possibly imply that the Council's interest in the development of the trade acceptance has lessened. No such thought could occur to anyone conscious of the fact that our domestic trade commands a position of vastly greater importance than our foreign trade, both as to volume and character. The enlarged program of the Council simply meant the inclusion of the bankers acceptance in addition to, not in substitution of, the trade acceptance, and the accession to the old Council of new members chosen from among the most prominent experts in foreign banking in the leading financial centers of the country. The Credit Men's Association continues to be represented on the Council by your energetic Secretary-Treasurer, Mr. Tregoe, and I feel certain that in its wider aspect our undertaking will enlist an even keener interest on your part than in the past.

The American Acceptance Council, upon your invitation and in anticipation of this conference, held here yesterday an all day session, when both the trade and bankers acceptance were carefully discussed in

highly instructive addresses and debates. Some of you were present at these meetings, and to all interested the speeches will be made available in printed form, so that it would be inadvisable for me now to go into a detailed discussion of the technique of the acceptance problem. I believe that you would prefer that I survey the field in broad outlines, with an incidental sketch of the future plan of operation of the Council.

Trade acceptances.—I shall touch only slightly upon the question of trade acceptances. You permitted me to go fully into that phase of the question about a year ago, and I have very little to add; except that nothing has developed to alter the views which I then expressed, and that quite a good deal has happened to confirm them. A constantly increasing number of merchants testify that by adopting the trade acceptance they have simplified their operations, strengthened their financial security, and thereby their general ability to do business. It is true that a few opponents continue an antagonistic propaganda, but their attitude reminds me of the resistance encountered at the time when Federal Reserve banks were making their greatest efforts to secure the membership of State banks and trust companies. Old-fashioned State bankers then used to sit up at nights figuring out to a nicety what they would lose by joining the Federal Reserve System. Detailed theoretical calculations were submitted and made the basis of their arguments. But while they were thus making out their hypothetical cases, those amongst them who were capable of vision and of a more national point of view had joined the system. When, later on, groups of banks were invited for a discussion of the "pro's and con's" involved in membership, Federal Reserve officials were mindful to have represented some State bank or trust company that had joined. These new converts invariably reported the fact that membership had not only given them greater security, but that it had also resulted in their increasing their earnings through their new affiliation rather than suffering a loss. That always closed the discussion. On the one hand we had hypothesis; on the other we had facts.

I am strongly inclined to believe that the trade acceptance discussion has reached a similar status. The hundreds of firms basing their evidence not on theory but on results actually achieved and benefits realized, tell their own convincing stories.

Acceptance Council's attitude.—When, as Chairman of the Council's Executive Committee, I recently addressed its first Executive Committee meeting, I tried to sum up its views in the following statement:

"We are preaching the gospel of the trade acceptance for no other purpose than that we believe its use makes for sounder business and banking conditions. We do not say that single name paper is not good,

or illiquid; but we may fairly say that the trade acceptance is better and more liquid. We do not say that the trade acceptance serves all purposes and that all cash sales and all cash discounts ought to be avoided; but we do say that where business is not done on a strictly cash basis, the trade acceptance will be found the safer, sounder, and, in the long run, more economical method than the open accounts.

"Indeed we believe that it is so much of an improvement over the open account that in some cases sellers, at present sacrificing a very heavy cash discount for the purpose of avoiding the dangers and inconveniences of open accounts, might find it to their advantage to consider the economy involved in the use of the trade acceptance when dealing with customers of strong credit.

"We do not want to appear as wishing to force upon anybody the adoption of the trade acceptance, unless he considers it as serving his better interest. We do wish, however, those who can profit from the method to study it carefully and not to hesitate to adopt it. The American Acceptance Council's interests in the matter is that whatever makes for better morals in business and for better credit and banking conditions is a decided benefit to the United States."

Anomalous rate structure.—It is true that during the last year the progress of the trade acceptance has not been as rapid as it might have been under ordinary circumstances; for while it has gained new converts in large numbers, measured in volume its growth has been greatly retarded by the anomalous war structure of our discount rates.

In normal times Federal Reserve banks would be expected to establish rates for bankers acceptances substantially lower than for single name paper, and about halfway between these two there should be the discount level for trade acceptances. That was the original scheme of the Federal Reserve Board when formulating its principles with regard to the rate schedules for the various classes of paper. Our entrance into the world struggle intervened, and in order to facilitate the government's war financing, justly entitled to our very first consideration, rates had to be established favoring the so-called war paper; that is, bills secured by government certificates or bonds. This led to an incongruous rate structure resulting in the present abnormal condition, when about 80 per cent of all the bills held by the Federal Reserve banks—that is, about \$1,800,000,000, out of \$2,150,000,000—consists of war paper. The total loans and discounts of member banks amount to roughly \$13,500,000,000. It is clear, therefore, that when engaging in rediscount operations with the Federal Reserve banks in order to provide for their commercial requirements, member banks primarily used their war paper, inasmuch as it commands the lowest of all rates. This

rendered illusory one of the main advantages originally intended to be derived from the ownership of trade acceptances and bankers acceptances—that is, a preferential discount rate.

Indeed, the differential between Federal Reserve bank rates for commercial paper and bankers acceptances having shrunk to approximately one-half of one per cent, it no longer leaves between them an adequate space for a third and an effective intermediate rate for trade acceptances.

The normal level for discount rates.—It has now become the country's very serious duty to liquidate as rapidly as possible the war paper and holdings of government bonds in the hands of banks and trust companies. This item, representing undigested government bonds amounting, it is estimated, to more than four billion dollars, constitutes one of the fundamental causes of banking inflation. In order to promote their absorption by the savings of the people and in order to encourage thrift by compelling borrowers, if necessary, to reduce their loans, Federal Reserve bank rates for paper secured by government bonds in due course will have to be increased. They would have to approach more closely the then governing rates for commercial bills, while rates for bankers acceptances should be held at a rate sufficiently lower to provide for an ample margin in their favor against single name paper. And between these two rates the trade acceptance should find its proper level.

As this process of absorption takes place, and as the government reduces the volume of outstanding Certificates of Indebtedness, acceptances may be expected to regain their proper position as the most available and safest pass-key to the facilities of the Federal Reserve banks. Ultimately acceptances are bound to become the main investment and rediscount field for Federal Reserve banks and this demand alone will create a large market for them at favorable rates.

It may take a year or two before this course makes appreciable headway, but it is to be hoped that at an early date we may see the beginning of a definite policy pointing in that direction.

British discount and gold policies.—In determining the future level of our bankers acceptance rates, the British discount rate will play an important rôle. Sooner or later our rate and the British must be brought into a proper relation. It is impossible to predict exactly in what manner this will be accomplished. Our British friends at the end of the war have now established a gold embargo, while it may be expected that our gold embargo will be raised upon the signing of peace, if not at an earlier date.

England's future foreign exchange and discount policy is still undecided. At present there exist two divergent schools of thought: One, led by Lord Cunliffe, believing that foreign exchanges must be brought

back to their pre-war levels by the establishment of a high British discount rate. That school holds to the old doctrine that high rates of interest will draw gold freely into a country enjoying a strong banking credit. If such a course were adopted, it might safely be followed by the lifting of the British gold embargo. The proponents of this policy are opposed, however, by another group of British political and financial leaders urging the maintenance of the gold embargo, preserving present artificially low interest rates under its protection, and allowing sterling exchange to remain at a discount in several foreign countries, particularly in the United States. It is difficult to see how such a policy, in the long run, may be expected to bring about a healthy cure. Whether or not it may be advisable for England to continue it as a temporary device is a matter that only British leaders can judge. My own belief is that sooner or later England, whose banking prestige and power have rested so largely upon the tradition of a free gold market, will adopt a course leading toward the lifting of the gold embargo, that is, a policy of higher and effective discount rates. To me it remains a riddle how note-issuing banks, on both sides of the water, could hope to effect "deflation" unless they take steps not only to arrest a further increase in their investments, but indeed to decrease them. And this they can achieve only by placing their active official rates above those of the open market.

Continued inflation or readjustment?—It is an evil condition that prolongs the necessity for governments to issue billions of bonds or currency for the purpose of paying millions of people who idle. It intensifies the inflation of prices because it continues to swell the outstanding amount of money and credit, while, at the same time, idleness interferes with a proportionate increase of goods. But this state of things, bad enough in itself, is aggravated most viciously if, in order to place government bonds (issued for unproductive purposes) upon a low interest basis, the general level of rates of interest is artificially lowered and bonds, instead of being absorbed by savings, are carried by manufacturing new credit, be it through added bank loans or circulation. "During war the laws are silent," is an old Roman saying, which applies with equal force to economic laws. But the war, happily, is ended and we must now boldly face the question of whether we wish unconditionally to surrender to inflation and accept it as a finality—that is, sacrifice all services rendered in the past to the services of the future—or whether we are determined to work toward a readjustment in the direction, at least, of the pre-war level, though nobody expects us even approximately to reapproach it.

It is a pathetic fact that peoples, like children, apparently can learn only from their own experiences, but not from the experience of others.

We know that war prosperity usually ends in a crash; shall we be able to avoid it?

Arrest credit expansion.—If such be our wish we must beware of booms based on a fake prosperity which has its roots in inflated credits and prices. It is an ungrateful and at present an almost superhuman task to stop the easy flow from our credit reservoirs that creates the enlarged foundation for our growing credit pyramid.

While the Federal Reserve System proved our salvation during the war and while our imposing reserve power may be destined to play a most important rôle in meeting some of the grave problems that still lie ahead of us, I believe the moment is near at hand when we must not permit this reserve to be further encroached upon for the sake of increased credit expansion at a time when the healing process must be sought in contraction. To apply that remedy may be a harder task than to follow the lures of fictitious prosperity born of easy money, but in the long run I believe it will be a more prudent and more charitable strategy. Such a course would not imply that we should be slackers in shouldering our full share in attacking and solving the world's burning economic problems. It means only that we must manfully and planfully husband our resources instead of squandering them by personal extravagances and headlong speculations—and that we must concentrate our efforts on doing the big constructive things with wealth bottomed upon solid production and saving, instead of resting it on the quicksands of further inflation of credit and prices.

We cannot formulate any definite opinion as to what will be the future level of our own acceptance rates until we have a clearer picture with regard to the scope of our future government requirements, the amount and the terms of sale of United States Certificates of Indebtedness to be kept outstanding in the future, and until we know what England's discount policy will be.

It is probable that in due course our discount rates for bankers acceptances will be on a par with (if not lower than) the English acceptance rate. Whether our rate will drop down to theirs, or theirs move up to ours, or whether possibly we shall meet halfway cannot be prophesied until governments and note-issuing banks have reached definite conclusions with respect to their future financial policies. It appears, however, to be a reasonable expectation that (even though we should lift our gold embargo and England should not), we may hope to be in a position to maintain an acceptance rate which will enable us to meet the British rate in world markets, and on a level substantially lower than our commercial paper rate, whatever it may be at that time.

Bankers acceptances and foreign trade.—As a consequence of the war, the indebtedness of other countries to us has become such that if these foreign nations are to be kept in a position to buy our goods, we shall have to grant them credits or purchase their obligations, or other assets. We are not yet fully equipped for the placing of foreign securities on a large scale; moreover, the credit of foreign governments in many cases is least well established in countries where the demand for our goods and credits is most urgent. But where government credit may be found inadequate, private credit may be of sufficient strength. People must eat and clothe themselves and certain industries in such countries may, therefore, well prove strong enough to warrant the granting of short credits involving the movement of our products to them or theirs to our shores.

American bankers acceptances may play a most vital rôle in meeting this emergency and promote thereby the all-important work of reconstruction, which has been so much in the people's minds but has been so slow and elusive in taking tangible form. Our banking system has attained phenomenal strength within an unprecedented short lapse of time. There is a vast opportunity for American banking enterprise to go out all over the world and to enter into new relations, promoting not only our trade and industry, but at the same time rendering vital services to the countries at present sadly in need of our help.

We may justly be proud of the spirit of enterprise shown by our banks in these new problems. The number of American branches and agencies opened in foreign lands exceeds seventy at this time, and is growing every month. They are now established in South and Central America, Asia and in Europe. In all these countries the dollar acceptance, and "dollar exchange" for which four years ago we modestly and prayerfully entreated a kind consideration, through force of circumstance have now been brought to a leading position. There are outstanding to-day, drawn in almost every part of the globe, approximately \$500,000,000 in American bankers acceptances. But this is only the beginning. Some months ago I ventured the prediction that in the not too distant future we should live to see American bankers acceptances reach the billion-dollar mark, and I have no hesitation in reaffirming that opinion.

What service the bankers acceptance lawfully may render in financing importations and exportations, not only into and out of the United States, but between all points of the globe, what steps our banks may take further to promote the use of these new American banking facilities, and the technique of drawing and making these acceptances, has been explained in a most instructive address delivered yesterday by one

of the ablest experts in this field, Mr. Fred. I. Kent, Vice-President of the Bankers Trust Company of New York. His paper elaborated at length the opportunities, duties and functions awaiting in this field for not only our bankers but also our business men.

Growing demand for acceptance facilities.—The growth of the American bankers acceptance business is likely to continue so fast that fear is expressed by some lest our available acceptance facilities may soon prove inadequate. It has been urged, therefore, that the limitations, placed by the Federal Reserve Act upon member banks of the Federal Reserve System, should be widened so as to enable these members to accept to a larger extent than the 100 per cent to 150 per cent of their capital and surplus, up to which limit they may accept under existing law. My own view is that we should be very careful not to overstrain the load of liabilities of our large deposit banks. Institutions often having deposits amounting to more than ten times their capital and surplus, and having invested a large portion of these funds in commercial loans involving credit risks, should consider very seriously whether it would be wise for them to add to their existing commitments acceptance liabilities in excess of the present restrictions of the law, unless, indeed, their general deposit liabilities were kept within very conservative limits. It would appear to be the dictate of banking prudence to preserve a certain safe relation between capital and surplus on the one hand and all liabilities, including those for acceptances, on the other.

Acceptance corporations.—It was in anticipation of these larger acceptance requirements that in 1916 an amendment was secured by the Federal Reserve Board authorizing national banks to invest in the stock of banks or corporations primarily devoted to the foreign acceptance business. Banks of this new type, under the Federal Reserve Board's regulations, are prohibited from taking demand deposits in the United States, and are required to keep their own resources, as represented by their capital and surplus, in liquid form, as a reserve, as it were, for the protection of their acceptance liabilities. In that case, it was held that it would be a conservative and logical policy to permit these institutions to have outstanding acceptances plus deposit liabilities equal to a liberal multiple of their capital and surplus.

If, as I hope, the demand for American acceptance credits should continue to grow, the creation of additional acceptance banks or corporations would best meet the situation. Under the present rulings of the Federal Reserve Board, an additional \$50,000,000 invested in acceptance corporations would easily provide further acceptance credits in excess of \$300,000,000.

Mr. F. Abbott Goodhue, Vice President of the First National Bank

of Boston, one of the most successful pioneers in the field of foreign banking, contributed a paper on this topic of "Acceptance Corporations."

Domestic bankers acceptances.—It is not, however, in foreign acceptances alone that bankers acceptances will occupy a prominent place. The domestic bankers acceptance, though not of equal portent, is also destined to play a rôle of great importance. Domestic bankers acceptances may be made for two purposes: first, to finance domestic shipments of goods, and second, to carry staples, provided that in the latter case the acceptor is secured by warehouse receipts (or similar documents) conveying title to standardized nonperishable staples having a wide market. The effective use of the domestic bankers acceptance is largely predicated upon the proper development of modern and safe warehousing facilities. A paper prepared by Mr. Rudolph S. Hecht, President of the Hibernia Bank and Trust Company of New Orleans, dealt fully with that phase of the question.

Domestic acceptances are most important as equalizers of money rates all over the country. It will be easy for you to grasp the great economic service they can render in this respect if, as an illustration, you bear in mind how, during the cotton crop season, acceptances made by strong Southern firms, and secured by properly safeguarded warehouse receipts issued by warehouses independent of the borrower, would readily find their way into other districts either through the intermediary of the Federal Reserve banks or through banks, dealers, or discount companies. They would thus relieve financial pressure in sections where seasonal demands might otherwise be heavy. Moreover, if acceptance facilities in such sections should become exhausted, banks in other districts could readily accept against these warehouse receipts, provided the latter are issued by warehouses responsible beyond doubt, and surrounded by proper safeguards.

Open market for acceptances.—Great headway has been made during the last year in developing a freer market for acceptances; the banks have reached a much better understanding of the proper principles to be observed in this respect. The pernicious habit, originally practiced, whereby the accepting bank held its own acceptances, has generally been abandoned, and to-day acceptances are being placed in a larger measure through dealers, other banks or discount corporations. Mr. John E. Rovensky, Vice President of the National Bank of Commerce, New York, gave our yesterday's meeting the benefit of his wide experience by reading a paper on "The Acceptance as the Foundation of the American Discount Market." He emphasized particularly the importance of the acceptance as an investment, both for commercial banks and savings banks, and explained how, after the redemptions of

the billions of United States Certificates of Indebtedness, the banks in due time would be driven into the purchase of large sums of bankers and trade acceptances for the purpose of using them as the most reliable secondary reserve.

This short sketch can give you only a very meager outline of what has been achieved in American acceptance banking during these last four years; it is meant to stimulate your interest rather than to satisfy it with respect to the vast possibilities the future has in store both for the banker and the business man.

Dangers to be avoided.—To point to the things to be done is, however, only one side of the Acceptance Council's functions: of equal importance is its duty to emphasize the things not to be done.

In this connection, I am reminded of a story I once heard concerning a man belonging to a species now soon to be extinct and to be found by our children in Webster's dictionary only, the "bartender." A man of this profession, in prehistoric times, was abandoning his position and was turning over the cash register to his successor. "Please show me how it works," said the newcomer. "I will show you how it works," said the other, "but I won't show you how to work it."

The inference is clear. Those of us who have helped in paving the way for the Federal Reserve Act and have tried to formulate amendments for the purpose of enlarging the Act from time to time—so as to keep it wide enough to meet the country's continuously growing requirements—know how impossible it is to write banking laws tight enough to prevent abuses without at the same time crippling highly useful powers, absolutely essential, indeed, if we are to compete in world markets with nations entirely free from legislative fetters. In these countries—I am thinking of England particularly—it is sound banking sense and conservative business prudence that constitute the unwritten, but none the less very effective, law, and it should be our endeavor to follow their example. We must have laws leaving some latitude; but within this latitude we must establish our own sound business usages that effectively prevent unwise abuses. Yesterday's addresses dwelt fully on this phase of our problem. Mr. David C. Wills, Federal Reserve Agent of Cleveland, read a most interesting paper on dangerous practices in using trade acceptances.

Remedying abuses.—With respect to bankers acceptances, permit me to give you just a few illustrations: it is clear that the Federal Reserve Act when authorizing domestic acceptances contemplated two kinds of credits; one, acceptances secured by readily marketable staples—but not to be secured by any other kind of goods, and two, credits to finance the transportation of any kind of goods. In both cases the

law prescribes that documents—warehouse receipts or bills of lading, respectively—are to be attached when the acceptance is made. Power, however, is given to accepting banks to release documents in order to facilitate the handling of the goods. But you can readily see that abuse is possible by presenting documents at the time the acceptance is made and using these documents over again, after release, to secure another credit. You can easily imagine, moreover, how under the guise of financing a domestic transportation lasting only a week or two, a 90-day credit might be secured, which thus might serve to carry articles other than readily marketable staples. It is evident, furthermore, how easily, by this method, these acceptances may be turned into unsecured transactions; and unsecured credits amounting in the aggregate to 20 per cent of the capital and surplus of a bank may thus be granted to one single party instead of 10 per cent as provided as the limit for similar loans under the National Bank Act. Should the law be amended so as to prevent such abuses, or should the Federal Reserve banks and the accepting banks get together and adopt measures to stop bad practices of their own accord? I do not think there can be any doubt as to which would be the better course.

Principles to be observed.—Irrespective of what our laws permit or prevent, and without attempting to formulate too technical or too scientific a rule, or presuming to give any but my own personal views in the matter, we may, I believe, enunciate these principles as generally recognized sound banking ethics:

These principles should not be understood, however, as applying to trade acceptances, or single name notes, which are instruments of entirely different character.

A trade acceptance is the obligation of a purchaser to pay to the seller the price of goods bought; it represents, as it were, a loan of goods.

The loan on single name paper might be held generally to represent a loan of cash; while the bankers acceptance is to be considered as a loan of credit. The bank granting an acceptance credit is not expected to advance cash; the customer is enabled to secure cash on the strength of the bank's credit, by the sale of the acceptance in the domestic market, or abroad as "exchange," and he is under contract to put the accepting bank in funds in ample time before the acceptance matures. No cash outlay on the part of the acceptor is thus involved.

As compensation, the acceptor receives a commission commensurate with the length of the credit and the risk involved.

Bankers acceptances ought never to be used in order to finance permanent investments, or for the purpose of furnishing working capital, or for providing funds for speculation in securities, staples, or other articles.

Bankers acceptances are primarily designed to finance goods in course of transportation and in their various stages from origin to final distribution.

Staples in warehouses may properly be considered as constituting a temporary stage between production and distribution (but it is a dictate of banking prudence that such staples, to be the basis of domestic acceptances, either be under a contract of or awaiting reasonably immediate sale or delivery into the process of manufacture, and that they never be carried as a pure speculation).

Goods in course of production in foreign countries under a definite contract for subsequent transportation, may be considered as offering a legitimate basis for bankers acceptances, even though the products may not yet be ready for shipment when the bill is drawn.

But care should be taken in all these cases that the proceeds of the goods will liquidate the credit if the sale of the goods takes place before maturity of the acceptance.

A reasonable number of renewals of acceptances are legitimate if, for good and valid reasons, disposal of the goods cannot be completed within the period of the first credit.

Where documents are released, the title to the goods, wherever possible, should be preserved; in any case a moral hold, if no other, ought to be maintained to this extent at least that, before the acceptor is paid, title to the goods should not pass into the hands of other creditors and if the goods are sold the proceeds should be applied to paying off the acceptor.

Bankers acceptances drawn in certain foreign countries for the purpose of furnishing dollar exchange are justified where they are to be considered as anticipations of drafts expected to be drawn within a reasonable time for the purpose of the transportation of goods in course of production (*e. g.*: crops). The law provides that they may be drawn for the purpose of "furnishing exchange" in countries where the customary means of remittance is the 90-day bankers acceptance.

Bankers acceptances ought to show by some reference on the face of the bill the nature of the transaction financed, as in England, where the bill generally refers to invoices, letters of credit, or bills of lading, as the case may be.

Acceptance risks ought to be properly distributed; it is bad banking to grant too large an acceptance credit to any single party, no matter how good its standing.

It is bad banking to grant unduly large acceptance credits on any single kind of collateral.

Bankers acceptance credits ought to be taken only from banks and

bankers of undoubted standing and of national reputation (and in the case of foreign drafts, of international reputation).

Acceptances ought to be made and sold for the benefit of the drawer, not for the accommodation of the acceptor.

The acceptance business, in many respects, is similar to insurance business. There must be a proper appreciation and a wise distribution of the risks involved. There must be a premium corresponding to the risk, and a recognition on the part of the insured that he is taking a serious chance in dealing with companies that are weak, or disregard sound business rules.

Voluntary adoption of sound practices.—These are illustrations of principles that I believe the business and banking communities ought clearly to recognize, and firmly establish and enforce. There is no doubt about their ability to do so if the Federal Reserve banks, under the guidance of the Federal Reserve Board, co-operate. The power vested in the Federal Reserve Board to declare acceptances as eligible or ineligible for purchases or rediscounts by the Federal Reserve banks gives them a practically unlimited control over the practices to be encouraged or permitted in the development of the usages of granting, drawing and selling bankers acceptances.

The field is new, however, and still unexplored in many corners. Unanimity as to the soundest principles and habits does not yet exist. Our problems will require certain adaptations of European practices to our own needs, and the best methods will have to be developed by careful study and common council.

The American Acceptance Council hopes to be able to do its full share in this work. It has established a relationship of close co-operation with a committee appointed by the Federal Reserve Board tilling the same ground. Together we hope to bring about a clearer understanding of the necessities of the case, to ascertain the best banking opinion, and then to make recommendations with respect to principles to be observed, usages to be adopted, rulings to be made, and, if required, legislation to be enacted.

The sounder and the more effectual the unwritten law of good practices adopted and enforced by common consent, the less the necessity for the Federal Reserve Board or Congress to regulate business by rigid laws and rules.

Individual and national thrift.—In closing, I should like to suggest to you a thought closely related to this question of wise or unwise use of credit and very much in my mind.

It has occurred to you, no doubt, how intimately connected at this time is the question of government financing and thrift with the problem

of interest rates, safe banking and credit. Every substantial citizen of the Union has become the owner of government bonds, and contributes, somehow or other, to the gigantic funds flowing into the government in the form of direct or indirect taxation. No one can escape the most inexorable form of taxation to which to-day almost every country is subjected in the form of inflated prices.

We all realize the determining influence that individual thrift will exercise in readjusting present abnormal conditions; individual economy must make up for the vast, and in war times unavoidable, waste of the government. But it is gradually becoming clearer and clearer to the country that now, at the end of the war, individual thrift must be accompanied by economy on the part of the government, and this leads to a growing recognition on the part of many that the financial methods of our government must undergo a thorough reform and reorganization.

A body of expert credit men such as this understands more clearly than any other group of men what the lack of system in budgeting, accounting and auditing has meant in the past, and what benefits proper and advanced methods may secure for us in the future.

How much credit would you grant to a department store that left it to each chief of a section, or even a sub-section, to enter into commitments obligating the corporation without any knowledge of what expenditures are being undertaken in other parts of the business, and without any single officer in the whole organization being conversant with the total commitments undertaken, or the revenues available to meet the obligations incurred?

How much credit would you grant to such a department store if you knew that only by the joint action of two officers could payments be authorized, but that it was possible for one of them to close shop and go home without first having provided for the proper financing of the business? Or if you knew that one department could be prevented from securing most essential articles unless some salesman, entirely disconnected with the particular transaction, could secure a favorable consideration for some particular transaction in which his own customers or friends at home were interested?

A national budget system.—That, substantially, is the condition of the United States. In the past the "department store" was in condition of such affluence that it did not seriously matter what each chief of a section committed himself to, or how extravagant he was. With a Federal budget, however, that now has reached unprecedented figures, and with the tremendous burden of taxation now resting upon the country, I believe that the time has come when the adoption of a national budget system is felt by all as a necessary reform to be undertaken

without delay. We should have a *permanent* staff or board, whose business it would be to examine and co-ordinate the estimated income and expenditures of all departments and bureaus, to pare down, without fear or favor, whatever is unessential so as to bring the expenditures within the scope of what reasonably we may expect to be able to raise, and, finally, to oppose extravagances, no matter what political influence they might subserve. We need a nonpartisan group of judicial and independent men constituting an element of continuity and expert knowledge, at the service of every new administration facing the intricate problems of taxation, amortization and governmental borrowing.

I believe it would be most timely for this convention of credit men to devote its attention to this question of a national budget system. The keen interest taken in it by many prominent leaders in Congress makes us hope that it will be taken up in the near future. Both parties, as a matter of fact, stand committed to it. The danger, however, is that those influences in Congress that have profited from the vicious practices of the past will bend their efforts to emasculate any thorough legislation and to give us a budget system in name only, but not in substance. It is most important, therefore, that a group of men as here assembled, reaching all parts of the country, should fully grasp the intricacies of the problem, that it should place itself behind the movement and see to it that those representing them will hear, in no uncertain manner, what are the earnest wishes of the people.

Greater economy in our financial administration is necessary in order to bring about a proper readjustment of prices and to bring back to a more normal scope taxation, which now endangers the further development of the country.

Our future as world bankers offers opportunities which baffle the imagination. The grasping of these opportunities may mean relief to a large portion of suffering mankind, but these opportunities are so large that even our phenomenal banking strength may sooner or later threaten to become exhausted unless scientific economy is practiced from top to bottom. Even the strongest is weak if he does not husband, or if he overestimates, his strength!

Dangers to be Avoided in Trade Acceptance Practice, by David C. Wills, Chairman of the Board, Federal Reserve Bank of Cleveland.

Reprinted by permission from a pamphlet issued by the American Acceptance Council, June 9, 1919.

The great Hebrew apostle to the Gentiles, in writing to a group of Christians whom he favored from time to time with his letters, told

them, when they thought they had the only troubles in the world, that "there hath no temptation overtaken you but such as is common to man." So it may be said in speaking of the dangers to be avoided in the trade acceptance practice—that there are no dangers connected with the use of trade acceptances that are not always prevalent when credit is extended or money is loaned.

The exception to this statement would appear to be that there are fewer dangers in the trade acceptance method than in any other method, except where title to the goods is retained or where collateral security is required. Like all new methods, the trade acceptance in American business will probably be attended by certain defects and errors of practice that will have to be dealt with somewhat like weeds in the growing crop, to insure a healthy growth of the crop itself, but there is no good reason for not adopting the trade acceptance system in place of the "open account system." It may be timely, therefore, to point out some of the pitfalls and improper tendencies. Several of the suggestions are prompted by banking and business prudence and are made for the purpose of insuring for the trade acceptance a use in agreement with the best banking opinion and in conformity with correct commercial usage.

First.—The mere fact that the paper is in trade acceptance form should not lead anyone to believe that proper investigation of the credit standing of the parties to the bill is not just as necessary as if the goods were sold on open account. If the trade acceptance is to mean anything beyond single name paper, there should be responsibility attached to the acceptor of the bill as well as to the drawer. While, of course, the bank discounting a trade acceptance for its customer may not require a statement of the acceptor, except for those who accept for unusual amounts, yet the bank is entitled to sufficient information so that it can determine whether the acceptor is of good moral and financial standing and may be relied upon to meet at maturity the amounts for which he has accepted.

Second.—The trade acceptance form of obligation should never be taken or given for overdue accounts.

The trade acceptance, as an instrument in trade and banking, has a specific function to perform and is used for one purpose only; that is, it is a negotiable acknowledgment of an actual sale of goods by a seller to a buyer and constitutes a promise to pay, covering a live transaction drawn for the time involved in the terms of the sale contract. In order to cover a number of small sales in one acceptance, no objection can be made to making the acceptance for the average time, but it would be an abortion of the trade acceptance method to secure an acceptance against an overdue account and then to treat it as a trade acceptance.

Third.—For the same reasons as mentioned above, a trade acceptance under normal conditions should not be renewed, since a renewed trade acceptance does not represent a current transaction. Instances have been observed where it was expected that a trade acceptance would be renewed from time to time on the plea that sales by the drawer to the acceptor were occurring each month aggregating or exceeding the amount of the trade acceptance. This, in my opinion, is not a good practice, and the acceptance should be drawn for a period corresponding to the sale and wherever possible for the actual amount due on the particular sale or the accumulation of sales. The exception to this latter statement takes place when it is necessary to issue acceptances in smaller pieces to facilitate their discount.

Fourth.—The giving and taking of trade acceptances should not be used as an excuse for granting unreasonable time in sales terms. If the buyer is receiving trade acceptances from his customers, these will be available for obtaining funds to meet his own acceptances. Therefore, in the use of the trade acceptance plan, unreasonable extensions of time should be avoided. While at the beginning of the trade acceptance movement it may have been necessary and desirable to offer inducements to obtain trade acceptances, the granting of additional time on a trade acceptance sale over an open account sale has never been regarded as prudent. In fact, undue inducements in the form of time and discounts in order to convert accounts into the liquid form of trade acceptances will, in my estimation, tend to cheapen the caliber of the acceptances thus made.

Fifth.—Some concerns initiate the trade acceptance movement in their business by beginning on their slow-pay customers. There is no objection to this method of itself, but there is serious objection if the concern attempts to market or discount these acceptances and makes claim to a preferential rate because of the two-name self-liquidating character of the paper.

One of the strong arguments in favor of the trade acceptance method is that it serves to show the bank the character of buyers to whom the borrower is selling, and whether or not these buyers pay promptly. The banker receiving for discount from his customer acceptances of companies of inferior credit standing and slow-pay reputation will not become very enthusiastic about making a preferential rate, and may even feel like revising upward the loaning terms to that customer. Not all trade acceptances are desirable for discount, and if a company is using the trade acceptance method for the purpose of reforming some of its slow-pay trade into prompt payers it is doing a thing in itself commendable, but in that case the acceptances should not be marketed or

discounted as first class trade acceptances, as offerings of this character tend to cheapen the trade acceptance movement.

The fundamental use of a trade acceptance is not primarily that of a vehicle for collection, even though it is apparent that many concerns using trade acceptances have that single conception of the proposition. We will avoid emphasizing the incidental beneficial phases of the trade acceptance movement instead of its fundamentals if we bear in mind that the principal mission of the trade acceptance is to liquify credit, improve the turnover and minimize credit losses, rather than consider it as an up-to-date method for collecting a bill. In other words, the trade acceptance should appeal even more strongly to the president, treasurer and manager of a company than it does to the credit man.

Sixth.—Vigilance is required in what is termed the “twilight zone” of the progress of trade acceptances—this being the period when the transition is taking place from the “notes payable” to the basis of “trade acceptances discounted.” During that period there may frequently be both “notes payable” and “trade acceptances discounted” appearing on the statements of borrowers. There is nothing in this situation to cause consternation or alarm, nor should it prevent the rapid growth of trade acceptances. Banking prudence here again asserts itself. The lender of the money will desire to know if the notes payable are being appropriately reduced as trade acceptances are being discounted. The means are available to every lender of money to determine this.

Indeed not only during the “twilight zone” may bills payable properly be given by a concern discounting its trade bills. In many manufacturing and distributing lines direct borrowing is necessary and proper to furnish the borrower temporarily additional working capital for the purchase of raw materials and seasonal stock in trade. The peak of the load occurs between the time when preparation for the season’s business is about completed and the time when realization on sales begins in substantial volume. Then “bills payable” should reduce and the “trade acceptances discounted” may increase temporarily, but the disclosed relation of the two together, to merchandise and other quick assets, the relation of each to the other and the relation of “trade acceptances” both discounted and held to known volume of sales and to the turnover, provide to the banker a basis for intelligent and precise analysis of the borrower’s statement of condition and the exercise of banking judgment. Just as in England and Canada the “overdraft,” which is equivalent to the cash advance, and the sale of bills receivable go together, so with us, the single name paper and the sale of trade acceptances have each their proper and legitimate place side by side in the balance sheet of a borrower.

As the English banker in extending a line of "overdraft," and as the Canadian banker in establishing a line for direct advance, have particular regard for the amount of invested capital in the business, so will our bankers in making advances on single name and discounting trade paper require that the sum of the two classes of accommodation granted at any time shall not exceed a proper relation to the borrower's own resources. It should never be forgotten that a business is expected to have a sufficient capital of its own to carry on its normal volume of trade without continuous or too frequent or too great dependence on its bank for borrowed money.

Some note brokers and dealers in commercial paper still claim that they cannot sell an unsecured note of a borrower when that borrower is selling or discounting trade acceptances. When one is reminded of the "window dressing" that frequently takes place in borrowers' statements issued at yearly or half-yearly periods, and when one remembers that the day after such a statement is issued the "notes payable" account of the concern may go up many thousands, one is amused at the assertion that it is less safe to lend money to a concern borrowing two ways during the transition period or for seasonal requirements. Candor, good faith, financial morality and security will take care of this situation. It is only fair to say that the majority of the bankers and note brokers with financial and business vision are meeting this difficulty and solving it.

Seventh.—There is the fraudulent acceptance—and, while this may not yet be in evidence, it is perhaps as inevitable as the spurious commercial paper that has cropped out and does crop out occasionally. As already stated, banks through their credit departments and other avenues of investigation should, of course, subject acceptances to as close scrutiny as other paper that is offered them for discount. For the purpose of misleading bankers and producing an instrument that *prima facie* represents a commercial transaction and is in the form of a trade acceptance, there will likely be a tendency on the part of unscrupulous persons to resort to forgery and to draw drafts representing fictitious transactions. The machinery is available for discovering and preventing abuses of this kind, and severity in dealing with offenders will reduce such instances to a negligible minimum.

Finally.—I think a danger exists when an attempt is made to force the acceptance method upon customers without proper explanation and education. Arbitrary action as a rule creates antagonism. On the other hand, understanding leads to co-operation.

Companies incorporating the trade acceptance plan into their businesses owe their customers a chance fully to understand and appreciate the advantages and superiority of the new method. To successfully

introduce the plan, companies must themselves thoroughly comprehend it in principle and operation, and have it fully understood not only in the office but by the selling force also. A good salesman, if he knows the merits of the trade acceptance, will "sell" it as well as merchandise to pleased customers, who in turn will desire to "try it out" in their own trade.

The trade acceptance method has already shown its ability to win its way when launched under proper auspices and when opportunity and facilities for discussion and consideration are provided. Its value is positive and enhanced by increased use. Satisfied users are enthusiastic in proclaiming its merits and in acknowledging its benefits to them. Its dangers are not inherent but potential, and develop only through abuse. They are identified, charted and readily recognized, and should easily be avoided.

Criticisms of Trade Acceptances.

Reprinted by permission from a pamphlet issued by the American Acceptance Council, pp. 24, 43-50, June 9, 1919.

S. B. Lewis, S. B. Lewis & Co., Philadelphia: Mr. Chairman, I have nothing but commendation to give for the acceptance, if properly used; but to answer Doctor Holdsworth's question, I do know of one instance where a hosiery manufacturer used the acceptance for one year, and at the expiration of the year he abandoned the system because he felt or found in actual practice that his credit men had been a little more lax in the granting of credit than they would have been had he had the old open account. Now that might be due to the credit man not having fully in his mind the fact that the taking of an acceptance did not necessarily make the buyer any stronger. However, I am answering your question. He did abandon it, and has not since taken it up.

J. H. Scales, Belknap Hardware & Manufacturing Company, Louisville, Ky.: This discussion has been rather elucidating. It has convinced me of one thing that I have always believed: that is, a trade acceptance—and I intend no discourtesy to any of you men—the trade acceptance under the present laws and under the present practices of the banks is nothing more nor less than a promissory note.

I don't want to deal in personalities, but I was particularly impressed by the address of Mr. Woodruff this afternoon. It reminded me of the old story when some one asked about a patient—that the operation was successful but the patient died. It is a fine thing from the banker's standpoint, as Mr. Woodruff presented it. He expressed the advantages of the two-name paper to the bank, and then he went on and expressed

the splendid advantage that would accrue to the bank if all the obligations that the bank held would be paid up. Well, I suppose that is a pretty good thing, but I sometimes wonder what would happen to all the bankers if all their notes were to be paid—they would have to go into the mercantile business or something else. I happen to be slightly interested in a bank myself, as a director, so I am not saying anything against the bankers, of course.

Once Mr. James E. Tanner took me to task for a certain heresy that I committed in the sale of commercial paper, and he sent me a pamphlet he had prepared on the subject of buying commercial paper. I answered that I wasn't interested in buying commercial paper; I was interested in selling commercial paper. That was the point I had in mind.

Now I hear you gentlemen talk about the advantages of trade acceptances, and occasionally I hear a man say that he goes into it "whole hog," so to speak, but the majority of the men I speak to say: "Oh, yes, I use it on some of our slow customers."

One man says: "I have tried it out on a few slow fellows, and it worked pretty well, but I wouldn't think of trying it out on our business as a whole. I am, about the trade acceptance, like a good many are as to prohibition; it is a fine thing for the other fellow." Another one says: "I believe in it, but I haven't had the nerve to try it yet. I am waiting for some one to try it."

Now, I certainly have nothing to say against it. I think it is a good thing. I think it has its place in commercial life, and perhaps, as Mr. Woodruff said there a while ago, the trade acceptance is a matter of individual choice. Some people may find that it will suit their business. If they do, let them go on in the use of it, but I think it is a mistake to say that we must get at this thing from a patriotic viewpoint. Governor Harding himself deprecates such an expression. To say that because it suits me, you must use it, I think is a mistake.

I have certain methods in business, and other people have certain methods in business, and they are convinced that it doesn't suit them.

I would like to ask these gentlemen how much they have analyzed the cost of getting trade acceptances. The advantages that accrue from it? You talk about advantages. Some fellows may have had advantages.

Mr. Woodruff said to-day that the open accounts were not worth anything. Perhaps, theoretically, that is true, but what does experience show? How many of you men, and your fathers before you, have done business on open account, losing a small percentage each year, but still considering those open accounts good and finding the open-account method the simplest way to transact business in this country?

A man told me the other day: "I thought the trade acceptance was a good thing. I tried it out on some of our customers, and I found the expense and the detail far exceeded anything that it could possibly save us." Have you stopped to count the cost of the literature and the effort and the postage, and last but not least, the cost of collection? When a trade acceptance comes in you have either got to discount it or you have got to give the banker—and it is his business to get it—you have got to give him a discount for handling that for you, and you have got to wait, and you have got to pay the discount when your returns run in, if they are running from three to five, or ten days, whereas you do not pay that in the case of a check.

I know something of the hardware business and of the iron business too, and perhaps the keynote of the success of Mr. Green in liquidating this obligation, as we heard this afternoon, was partly due to this fact—he started in with pig iron at \$16 a ton and wound up with it at \$50 a ton. I know some other people who made money and not by using trade acceptances.

You have heard the difficulties of having acceptances sent to other banks, and I doubt very much whether the Federal Reserve Board or anybody else will be able entirely to eliminate that difficulty.

Down in Kentucky—and I suppose you have the same trouble in other States—when you send a man a trade acceptance who lives out at Rabbit Harbor or some other place like that, I tell you he doesn't know what you are talking about and he couldn't handle it if he did, because there are no banking facilities to reach him.

Professor Holdsworth raised the point awhile ago—and I hesitate to discuss it in front of such a learned man—that the cash discount terms are better than trade acceptances; that is the point to prove. Perhaps I cannot prove that to Professor Holdsworth's satisfaction as an academic proposition, but I am like the old merchant; when some one asked him how much profit he made, he answered: "One per cent." That was criticized. The man says: "Aren't you afraid you will go broke?" "No," said the old merchant, for he "bought for one dollar and sold for two dollars." I know for a fact that cash discount items are profitable.

It is right that a man should have a premium for paying his bills promptly, and it is to the dealer's advantage to give that premium. It is right to differentiate between the prompt payer and the slow payer.

Some one said it was born of necessity about the time of Civil War. Necessity was the mother of invention, and I want to tell you that that case of necessity invented the best system of doing business that has ever been invented—the American cash discount terms. Now I don't suppose many of you agree with me on that.

Trade acceptances, as I said awhile ago, are a system of promissory notes in a different form. Any system involving a note issue is a system of inflation. Now that is some advantage to banks, too. Banks have made more profit during recent years through inflation, especially because of government extension of credit.

Professor Holdsworth said that we ought to be big enough and broad enough to say "all right" to the other fellow to adopt it. I wish every competitor really had adopted the trade acceptance system: I think it would make it much easier. But it is significant, gentlemen, that so far as I know in our particular line of business, without any conference on the subject, almost every concern in the wholesale hardware business is opposed to the trade acceptance business.

I think I express no breach of confidence when I mention such men as Mr. Henry Thompson of Cleveland and Mr. Joseph Charles of Chicago and firms in St. Paul and Duluth and St. Louis and, before his death, Mr. Robert Biddle of Philadelphia. There are others, of course, who favor it, but I believe a majority of these concerns are strongly and bitterly opposed to the use of trade acceptances. Of course, they say if the other fellow wants to do it, it is all right. But, gentlemen, I believe that there isn't any system better than the system of cash accounts and proper terms, and a consistent policy of collecting. Don't be afraid of your customer. Tell him to pay his account when it is due; that is the whole secret of it, and it won't need trade acceptances to do that.

I believe that such a system as this trade acceptance will not be necessary. It may be adaptable in a few instances, but I think the Association of Credit Men will make a mistake to advocate it as a general policy good for everybody.

Dealing in Acceptances.

*From the Federal Reserve Bulletin, vol. 7, pp. 1166-1170
(October, 1921).*

Definition of Term "Dealer."

The following description of methods employed in buying and selling acceptances is based upon the answers to questions furnished by the principal dealers in New York, Chicago, and Boston, who have kindly agreed to give this information. As the inquiry has been confined to dealers' practices, it is desirable to define the term "dealer" as it is employed in this article. An acceptance dealer is an individual, firm, or corporation engaged in actually buying and selling the acceptances of others. A portion of the profit that may be derived from such operations comes from disposing of the bill at a lower rate of discount

than that at which it is bought, and bills are bought to be sold as speedily as possible. Thereby the acceptance dealer is to be distinguished from the investor on the one hand, and on the other, from institutions that find their profit in granting acceptance credits. Institutions that do a direct acceptance business may at the same time buy and sell acceptances of others in addition to handling their own obligations, but the term "dealer" has in general been restricted to those who "deal in" the acceptances of others. One reporting dealer, however, who has the privilege of accepting bills, has at times exercised that privilege to a considerable extent. Another dealer who also has the right to accept does not make use of it.

Function of the Dealer.

The function performed by dealers as intermediaries between accepting banks and houses on the one hand and investing banks and the public on the other is quite evident. In the absence of a ready market for the sale of acceptances, an accepting bank may find it necessary to carry its own acceptances for the drawer, and in that case the accepting bank is put in the position not only of granting its credit to the drawer but of actually carrying him. The result is that the purpose of the establishment of the acceptance credit, namely, to lend currency to a bill on which the drawer can realize without engrossing the resources of the accepting bank, has been defeated. Or, if the bank is not constrained to hold its own acceptances, it may have no other recourse than to negotiate directly the sale of these acceptances to investment institutions. To do this effectively on any large scale, however, necessitates a considerable organization and a large variety of bills, and for many banks this would be quite impracticable. Moreover, when bills are marketed directly by the acceptor, conditions are not as favorable for achieving an impartial appraisal of such offerings by the open market as they are when the bills have been subjected to a process of evaluation by passing through the hands of men whose business it is to deal in acceptances.

In short, the services of the dealers are similar to those performed by middlemen everywhere, *i.e.*, the creation or, more exactly, organization of a market to which both buyers and sellers may resort without loss of time and in the expectation of finding a scale of prices, or, as in this case, of rates which reflect current market conditions. The existence of a market for acceptances which can be relied upon by sellers to absorb their offerings immediately depends upon the extent to which a professional dealer's demand has been built up, as direct reliance upon the investment demand means an appeal to a heterogeneous group, which in turn means numerous, unco-ordinated, and uncertain markets. The

dealers, however, in order to be in a position always to handle all legitimate offerings, must in their turn not only have established extensive contacts with many types of investors, but they should also be able at all times to secure sufficient funds at rates low enough to make it possible for them to carry large and well-diversified portfolios at a moderate profit. The margin of profit secured by the dealer from the difference between his bid and offer prices is, in a well-developed market, more than compensated for, from the point of view of the seller, by the advantage that comes from instantaneous sale. By securing acceptances from various sources, dealers are also in a position to facilitate sales by the variety of their offerings as regards names, maturities, denominations, and other factors. And, being specialists, the dealers are, as already indicated, in a position to arrive at the true open-market appraisal of the bills that pass through their hands. If one fails to do so, the competition of other dealers will force conformity. The result is the establishment of more equitable rates and a broader and more fluid market, which again encourages and, indeed, is an indispensable preliminary to a further extension of a properly conceived acceptance business.

Number of Dealers Furnishing Data.

The information which follows is based upon reports received from dealers operating in New York, Boston, and Chicago. Of the six reporting dealers doing business in New York, two have their main offices in Boston. The Boston offices also made reports concerning the extent of their dealings in that market, while all other returns from Boston and from Chicago came either from branches or from correspondents of three of the six dealers mentioned.

Purchases of New York Dealers—Amount and Sources from Which Obtained.

In order to obtain an idea of the magnitude of dealers' operations in the several markets and the relative amounts purchased from various classes of holders, dealers were asked to state the average amounts of the portfolios carried during the year ending June 30, 1921, and the per cent of the total purchases obtained from drawers, from acceptors, from indorsers, and from all other sources. In New York the sum of the average amounts of the portfolios carried by six reporting dealers during the period in question was approximately \$54,000,000, and, considering the rapid turnover, it is evident that these dealers did a large volume of business in the course of the year. As a matter of fact,

business done by nonreporting dealers in the New York market was so insignificant that the returns as given are practically inclusive. The greater part of the acceptances purchased by the six New York dealers came directly from accepting banks and, with one exception, were around 50 per cent or more of total purchases. The average amount of all purchases obtained from acceptors was 50.5 per cent (average weighted according to the size of the average portfolio); from indorsers, 16.3 per cent; and from all other sources, 33.2 per cent. Four of the six dealers who reported separately purchases obtained from drawers showed the following distribution: From acceptors, 48.6 per cent; from indorsers, 14.8 per cent; from drawers, 11.5 per cent; and from all other sources, 25.1 per cent. A desire was expressed by a number of the New York dealers to encourage the presentation of bills directly by drawers or indorsers. It is evident that this preference lends support to the statement set forth above, namely, that the less the reliance placed by the drawer upon the accepting institution in disposing of his bill the more sharply defined becomes the fundamental character of the acceptance as a loan of credit and not a loan of funds by the accepting bank. Naturally, in the slow upbuilding of a new institution, the theoretically most desirable processes are not always immediately capable of adoption; and so it is in the present instance, as dealers who expressed a preference for receiving bills from the drawer or indorser nevertheless obtained not much more than a quarter of their holdings from those two sources.

Purchases of Boston Dealers.

The returns from three of the four reporting Boston dealers gave estimates of the average amounts of the portfolios carried during the year ending June 30, 1921. The sum of the averages so reported amounted to approximately \$5,000,000, but as the returns for the Boston market do not include all the local dealers, their significance is found chiefly in connection with statements of the sources from which these bills were obtained and the way in which they were distributed among investors. Over 90 per cent of the acceptances bought by three dealers were obtained from the acceptors. The combined percentages, weighted according to the size of the average portfolios, were 93.3 per cent for purchases from acceptors; 5.7 per cent from drawers; none from indorsers; and 1 per cent from other sources. A fourth dealer, who did not give actual percentages, stated that the largest supply of bills came directly from accepting banks and that direct purchases were made from only a few drawers.

Purchases of Chicago Dealers.

The average size of the portfolios carried by three reporting dealers in Chicago cannot be exactly determined, but the sum of the averages was probably between \$3,000,000* and \$4,000,000 during the year ending June 30, 1921. No attempt has been made to average returns showing the percentages of total purchases obtained from various classes of holders, as the percentages showed such a wide spread that averages would be misleading. The major portion of the bills dealt in, however, came from acceptors.

Location of Accepting Banks.

In all three cities the acceptances dealt in were in large part those of local institutions, but in the Boston and Chicago markets they were in general obtained from a more restricted area than in the case of New York. Although the acceptances of New York institutions constituted at least 70 per cent or more of the purchases of at least three New York dealers for the year ending June 30, 1921, the New York houses nevertheless obtain bills over a wide area, and some of the reporting dealers make purchases in other large centers through the medium of branches or correspondents. Out-of-town business is generally secured largely by means of the telegraph and telephone, and its origin no doubt depends chiefly upon established connections made through other types of activity in the commercial paper and securities markets. Locally, representatives of the dealers call daily on designated banks to find out what bills are for sale. Purchases are made outright as a rule, and only in a very limited number of instances, and then infrequently, do some dealers act as brokers in the purchase and sale of acceptances. In the Boston market over 90 per cent of the acceptances dealt in by the reporting houses were those of banks located in that city, while the rest were acceptances coming chiefly from banks in the larger cities of New England, although the market also absorbed some New York, Chicago, and western bills. The methods of getting into touch with local banks and outside interests are the same as in New York. A similar situation is found in Chicago, where the major part of the acceptances dealt in originated with Chicago banks.

Arranging Acceptance Credits.

Practice differs among dealers in the matter of making arrangements whereby individuals desiring to obtain credit in the form of acceptances can be put in touch with banks that will accept for them. Some houses prefer not to undertake to make these connections, believing that

discussion should be held directly with the banks and that intervention may put them under obligations to market the bills drawn. Others are ready to perform this service regularly and systematically.

Denominations of Bills.

Bills are very commonly drawn for sums ranging from \$5,000 to \$25,000, and \$50,000 denominations are not unusual. When an acceptance credit is so large that it becomes desirable for purposes of sale to offer it in the form of several bills, only one bill will, as a rule, be drawn for the odd amount. But in the case of import bills, especially, odd amounts are frequent, and the sums involved are often less than \$5,000. One dealer states, however, that his actual range during the past year was from \$10 to \$800,000.

Sales Distribution, by Classes of Investors.

With a view to determining the relative importance of the various groups of investors to whom sales of acceptances were made during the past year, questions were put concerning the percentages of total sales, exclusive of sales to Federal Reserve Banks, made to savings banks, to other banks, and to corporate and private investors. Inquiry was also made concerning the territorial distribution of the sales effected. The distribution of acceptances among the several classes of investors showed great variation from dealer to dealer, making average percentages misleading in some instances. For the six New York dealers sales to banks other than savings banks averaged over 60 per cent of total sales for the year ending June 30, 1921. The sales to private individuals and corporate investors ranged from less than 10 per cent to over 15 per cent, while the distribution to savings banks was highly irregular, varying from less than 5 per cent to a maximum of 50 per cent. The figures showing distribution of the sales of reporting Boston dealers, if given in the form of averages, are not typical, as one firm disposed of much the greater part of the acceptances handled to savings banks, with few sales to other banks, whereas in the other three cases the practice was the reverse. Sales to corporations and private individuals were also variable, but for three dealers the average was about 15 per cent. The information obtained from Chicago concerning sales distribution was not available in sufficient detail to afford comparable statistics.

Sales Distribution According to Location.

The data given above show that the chief reliance of the dealers in seeking a market for acceptances has so far been the banks. The

location of such purchasing banks is a matter of interest, and questions were accordingly asked concerning the territorial extent of sales distribution. In the case of New York dealers, it appeared that about 50 per cent of the sales to banks during the past year were made in New York City or vicinity. The outside distribution is widely scattered, but acceptances are chiefly lodged with the banks in the larger cities. One dealer says that his firm has distributed bills in 38 States and more than 400 cities. Most of the regular dealers are also engaged either in selling commercial paper or in handling stocks and bonds, or else they follow both lines of activity. Hence they are in a position to utilize the existing selling organizations and to place acceptances through their branches or through correspondents. In New York City special salesmen are sometimes employed, and in all cases daily visits by firm representatives are made to banks and other institutions who may be possible purchasers of acceptances. One dealer has a special local selling organization, consisting of a manager of the acceptance department and six salesmen in New York City, to cover all classes of investors in bills, *i.e.*, national banks, trust companies, savings banks, insurance companies, other corporations and firms. The private investors are taken care of by the private investors' department. Sales of reporting Boston dealers were largely confined to Boston and New England, but were widely distributed within that territory. One house, for example, stated that it had covered 150 New England cities and towns as well as a number of middle western and western cities. The sales of reporting Chicago dealers were largely confined to the Seventh Federal Reserve District and were chiefly made to the smaller banks in the country.

Methods Employed in Selling Outside City.

General and very extensive reliance is placed upon circularization for effecting sales to outside interests, supplemented by the use of the telegraph and telephone. The daily offering sheets, sent out as a rule to the number of 500 copies or more to the principal banks and a few corporations and individuals, are an important means of securing orders, especially from outside the city. In the majority of cases no use is made of traveling representatives in furthering the sale of acceptances except in connection with the transaction of other business. However, the Boston office of one dealer has three traveling salesmen who devote the major part of their efforts to the promotion of the acceptance business, while in the New York office of the same house three men spend part of their time visiting out-of-town banks. Another dealer, with a large number of branch offices throughout the United States, reports that although the salesmen are primarily interested in the distribution

of long-term securities, they also carry acceptances regularly and transmit orders to their respective offices, from which such orders are forwarded to one of the four large cities in which acceptance portfolios are carried. A third dealer, with correspondents in nine large cities located in eight Federal Reserve districts, buys and sells prime bills through these correspondents. It should be remembered, however, that the New York banks which purchase acceptances frequently do so for correspondents scattered over a wide area. Otherwise, as stated, the outside distribution is largely governed by the location of branches, affiliations, etc., of the respective dealers. The majority of dealers state that they do not indorse the acceptances that they sell, although one house has indorsed a very limited amount but only "for a consideration."

Borrowed Funds—Amount and Terms on Which Obtained—New York Dealers.

A question concerning the average amount of borrowed funds used in carrying acceptances during the year ending June 30, 1921, brought out the fact that in the New York market three reporting dealers borrowed all funds so employed. This is possible because of the fact that such dealers have established banking relationships and obtain the necessary advances in connection with other lines of business. Only one large dealer, whose principal business consists of buying and selling acceptances, has a substantial capital devoted directly to the purchase of acceptances and constituting a considerable percentage of the funds employed. For all six reporting New York dealers the percentage of borrowed funds on the average to the average size of the portfolios carried was 84 per cent. Borrowed funds are almost without exception obtained on call, although in two instances it was stated that a negligible amount of time money had been occasionally used. The rates for time money, as a matter of fact, have not been low enough to enable it to be used in making purchases without a loss, or at least on the few occasions when it has been available the call rate has been even more favorable. In any case, the uncertainty in regard to the ability to utilize funds continuously makes it usually undesirable to borrow for fixed periods. The aim is to borrow just enough from day to day to take care of the daily purchases and to dispose of the bills so bought immediately. It is striking that one dealer alleges that the average yield of his portfolio did not exceed the cost of carrying in the case of prime bills, while the yield exceeded cost by as much as 1 per cent or more on nonprime bills. In another case the average yield did not exceed the average cost, and in three other instances

the average yield exceeded the average cost by from one-eighth to one-half per cent. The weighted average (*i.e.*, weighted according to the size of the average portfolios) gave the average yield for five reporting dealers as 6.2 per cent; the weighted average (weighted according to average amounts borrowed) gave the average cost of the loans as 5.9 per cent.

Borrowed Funds—Boston and Chicago Dealers.

For three Boston dealers furnishing information in regard to amount and cost of borrowed funds, the proportion of average total borrowings to the summed-up total of their average portfolios was 92.6 per cent for the year ending June 30, 1921, and the average yield of these portfolios was just equal to the average cost of borrowed funds. Call loans were, with occasional minor exceptions, exclusively employed. Although returns from Chicago were incomplete, two reports showed that portfolios were carried entirely through the use of borrowed funds. In one case the average yield was just equal to the average cost of the borrowed funds. In the other cases the average yield was not given, but as the average cost of borrowed funds was slightly higher than in the first instance, it probably was at least equal to the average yield.

Significance of Narrow Margins Between Average Yield and Average Cost.

It would appear from the data given above that the operations of reporting dealers in Boston and Chicago were not carried on upon a basis to yield a profit directly. Indirectly, however, there may be a certain amount of interchange between branches of the same firm or between correspondents, which in the long run may be worth while, even though it brings no addition to the net earnings of the outside dealer. Even in New York City the margin between average yield and average cost was narrow and in one case nonexistent. It is obvious, therefore, that a very slight change in rates may bring losses to the dealer, and if, when the demand for bills is light, he is carrying a heavy portfolio on money borrowed at rates higher than the average yield on his bills, his continuous daily loss may easily become so large as to force him to liquidate his bills at whatever they will bring and retire from the business. In any case a rapid turnover is essential if borrowed funds are to be used profitably. To the extent that dealers are employing their own capital in the direct purchase of acceptances, their ability to hold these acceptances under unfavorable conditions of the money market is obviously strengthened. They can at least carry their purchases for what they will bring, and their loss, if loss it be, on

the capital investment merely involves a foregoing of what might have been secured in alternative forms. But as few dealers have much capital directly invested in the business, and as they employ call-loan funds almost exclusively, rapid conversion is at times essential. When the investment demand is not adequate to absorb the offerings, the market is supported by those Federal Reserve Banks which are ready to buy acceptances from dealers under repurchase agreements limited to 15 days. Except for funds so made available by Federal Reserve Banks, loans are obtained by the reporting dealers very largely from local banks. In view of the existing situation, it is evident why preferential rates are granted to dealers by certain banks anxious to build up the acceptance market by providing it with a steady flow of funds at rates that enable the proceeds to be used in buying bills.

Conclusion.

A broadening and stabilizing of the dealers' market is highly desirable for reasons already set forth. The expansion need not be limited by the rate of growth of acceptance business in general, but should proceed at a faster pace as it becomes more generally recognized that dealers have a function to perform that is vital to the upbuilding of a broad and dependable open market. Dealers will, however, only be able to expand their purchases and thereby offer a ready outlet for acceptances in proportion as they can feel assured of being able to control adequate supplies of credit at rates that yield a necessary profit. Moreover, an increase in the scale of their operations implies an expansion of the investment demand which they satisfy. It is evident that there exists a large opportunity for the development of such an investment demand, especially among corporations and private individuals, as so far dealers' sales have been principally confined to banks.

The Commercial Paper Business.¹

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This article gives the results of a study made by the Division of Analysis and Research of the more important aspects of the commercial paper business. The endeavor has been to describe in turn current practice with respect to the placement of paper with purchasers, its acquisition from borrowers, and the operation of the commercial paper house. The study is based upon data from 12 distributors, 10 of whom had paper outstanding on June 30, 1921, amounting to \$609,000,000,

¹ Prepared under the direction of W. H. Steiner, Division of Analysis and Research.

out of a total reported by 27 houses to the Federal Reserve Bank of New York of \$707,000,000.

There are two central features of the commercial paper business which should be kept in mind. These features are influential in determining the organization of the business and the operating methods of the individual dealers. The first feature is the service of the dealer in linking up the several sections of the country, so that a national commercial paper market in effect tends to be established, to which the individual borrower may have access. By this means, too, a territorial distribution of funds is obtained under our system of many small independent banks, and surplus funds in some sections are rendered available to borrowers in other sections where an insufficiency of local funds exists. The distribution changes from time to time as conditions in the several sections change. The commercial paper dealer acts as a regulator of this process and serves to connect the different sections. The second feature relates to the part played by the dealer in the credit system of the country. He scrutinizes carefully the volume of credit to be extended to the open-market borrower, and serves as a source of information as to the standing of these borrowers, on whom he maintains an elaborate credit file.

I. Commercial Paper Markets.

The commercial paper business is concentrated. About 15 large houses (counting one group as a single house) do the great majority of the total business of the country. A few houses confine their activities entirely to dealing in commercial paper, but the majority also deal in securities, and in certain cases are members of stock exchanges in leading centers.

Branches of commercial paper houses.—The organization of the large house is highly centralized, and the entire system of branches which it maintains is directly under the control of the principal office. Of eight large houses which are among those who maintain an elaborate system of branches, four have their head offices in New York, three in Boston, and one in Chicago. Four of these houses have less than ten branch offices (namely, from five to nine), and cover the territory tributary to these offices in large part through salesmen. The other four houses have ten or more branches. Two of the latter make a distinct territorial division, and have branches in each section tributary to a head office for that section. The location of these sectional head offices is as follows: Two houses each in Boston, New York, Chicago, St. Louis, and San Francisco, and one house each in Philadelphia and

Seattle. One of the two houses thus divides the Pacific coast territory into two parts—north and south.

A further indication of the scope of the system of branches is afforded by the following table, which shows, for the eight large houses cited above, the number of houses having branches in each center:

OFFICERS OF EIGHT LARGE COMMERCIAL PAPER DEALERS.

Boston	7	Chicago	8
Hartford	3	Minneapolis	1
		Omaha	1
New York	8	Denver	1
Philadelphia	6		
Scranton	2	St. Louis	5
		Dallas	2
Richmond	2		
Atlanta	4	San Francisco	7
		Los Angeles	5
Pittsburgh	4	Portland	3
Cleveland	3	Seattle	3
Detroit	2		
		Total	77

This table serves to indicate the chief commercial paper markets, as well as in a broad way which are the principal and which are the lesser markets. This of course does not imply that the volume of business done in each of the principal or the lesser markets is by any means the same.

Several of the houses have correspondents in certain sections, instead of branch offices. One house states that "of the 11 or 12 leading commercial paper houses in the country at least 6 have no affiliations. Most of the others have affiliations in one territory or another." Another house explains their use as due to the fact that they have been found to be cheaper than salesmen in covering the particular territories where they are employed.

One group of houses, which does a considerable business in the aggregate, is organized on the correspondent principle. That is to say, about six firms located in as many of the leading commercial-paper markets, and each confined to a limited territory, mutually act as correspondents and divide the profits on paper sold, as is the general rule where correspondents are employed. The group then in effect parallels one of the larger houses which covers the country as a whole through a system of branches of its own. Small dealers are also more or less associated in other markets with local houses who act as their correspondents. Some dealers report a considerable number of them in New York and Chicago, but in general it is stated that they are found more largely in Philadel-

phia than elsewhere. One dealer states that the development of these dealers in Philadelphia was due to their old family connections, but that they are gradually decreasing in importance. Small dealers, it has been stated, endeavor to originate paper for their own account, although the majority of their business may result from having affiliations who supply them with more paper than they are able to originate themselves. They may use their personal connections, suggests one dealer, in obtaining local accounts, whose paper they will undertake to distribute in the immediate territory in which the firm is located.

Sections of the country.—It is evident from the above discussion that each house has its own method of dividing the country into several sections. Aside from differences in the number of sections, the territory assigned to an office located in a certain center by any two houses by no means exactly coincides in all cases. In a broad way, however, certain sections are generally distinguished, into which the country naturally divides itself from the point of view of the commercial-paper business. These are the New England, North Atlantic, South Atlantic, Middle West, Southwest, and Pacific coast sections. Some houses combine the North and South Atlantic sections into one, while others again further divide the North Atlantic section into two, covered, respectively, by New York and Philadelphia. In general, the South Atlantic section is regarded as more closely associated with the North Atlantic section, but one house associates it instead with the Southwest. Further division of the general sections is of course possible, and thus, *e.g.*, the Northwest may be distinguished from Chicago territory, although this is not usually done. Each general section has a leading center. These correspond as a whole to the centers given above, in which the head offices for particular territories shown by three houses are located.

The basis of this territorial division is indicated by one dealer as follows: "The divisional basis is from several viewpoints: First as to the banking center which the banks in that community use as their correspondent. It has always seemed that this has been largely governed by the flow of money in that district. Second, the nature of the crops, as indicating at what time or periods of the year surplus funds are likely to occur in those sections. The southern States, as their largest commodity crop is cotton, are periodical in the buying of paper, and bank principally through St. Louis and New York, very little of their money naturally flowing to Chicago territory. There is, however, a noticeable difference in the case of the southwest and southeast territories, as the States comprising the southwest territory use St. Louis and Chicago practically as much as New York."

Retracing our steps in point of time, it is found that the several sec-

tions have only gradually developed and become differentiated. Thus it has been stated by a leading dealer that St. Louis banks at first did not want to purchase paper, but changed their attitude after the financial strain in that center in 1897. The principal distinction for many years has been between the East and the West, the dividing line between the two running north and south through Pittsburgh. The line is stated by some dealers to be still of considerable importance, although others speak of it as "more or less done away with." One dealer states that from time to time there has been some discussion as to whether Pittsburgh belongs to eastern or western territory, but that his house has always maintained that the entire State of Pennsylvania belongs to eastern territory, and in every case where it has the eastern account, insists on obtaining the entire State. He remarks that "some western brokers have frequently made a fight on Pittsburgh, but as far as our own experience is concerned, have always lost." These statements coincide with the remarks of another dealer that "the Pittsburgh market is sometimes handled from Chicago and sometimes from Philadelphia."

The Pittsburgh line, as just indicated, is important in connection with the division of an account among several dealers, each of whom then handles the account in a certain section. "Many large firms, which are very large borrowers of money," states one dealer, "divide the entire country among several brokers, thinking by this method they can place more paper on the open market, which is undoubtedly a correct assumption, as some brokers are better established in certain territories than others. Only the very largest users of money make an extensive division, although quite a number of well-known houses have an eastern broker and a western broker." The packers afford the conspicuous example to which reference is generally made when indicating firms who regularly use several dealers. In this connection another dealer mentions the existence in the past of a sharp divisional line east and west through Effingham, Ill., then along the southern boundary of Indiana east to the Pittsburgh line. Westward the line ran to Denver, with another divisional line north and south through Denver, and the country was thus divided into four parts, a different dealer being used by very large borrowers in each section. One dealer states that he only divides territory now with a local broker, *e.g.*, in Chicago or Indianapolis, and that he dislikes the practice, as it renders it difficult to follow the amounts borrowed.

II. Placement of Paper.

Shift of paper between markets.—Aside from its relation to the organization of the individual house, the importance of territorial divi-

sion of the country lies in its relation to seasonal purchasing of paper. It is thus possible for the individual house at certain seasons of the year to shift paper originating in one section to buyers in another section. In normal times reliance is regularly placed upon certain sections to take paper, although in the last few years conditions have been such as largely to vitiate the normal seasonal trend.

The seasonal movement is found principally in those agricultural sections in which reliance is placed upon one principal crop. The dealer will watch for easier money conditions in these sections after the crops have been moved and time his efforts accordingly. The exact time of course varies from year to year, according to the abundance and rapidity of movement of the crops. In a general way, the South, including both southeast and southwest, normally should purchase paper from November or December through to March, when cotton has moved. This has not, of course, been true this season. The Northwest is also distinctly a seasonal market, and is ordinarily especially active in the fall and winter months, when grain has moved. The Central Western States, however, practice diversified farming, and purchase more or less continuously throughout the year, heaviest purchases perhaps following the wheat crop in July, August, and September. "It has long been a practice," states one dealer, "that the farmer uses the proceeds of his wheat crop to pay off his bank indebtedness, while the funds received from the other crops are used either to put in the new crop or to carry him over the dull season." On the Pacific coast, and principally in California, the savings banks provide a market throughout the year, although the maximum purchasing occurs directly after the fruit crop is marketed. In the East and New England, steady purchasing is the rule.

The seasonal movement will also be found with respect to the lesser crops. Thus a Philadelphia house states that it watches the tobacco situation in Pennsylvania, while a Chicago office states that the Michigan fruit district always purchases paper in September and October.

On the other hand, banks in the financial centers are more steady purchasers throughout the year. In fact, one dealer states that "country markets vary with crops; city markets vary with change in business and money market conditions." During the last few years conditions have been such as to emphasize the latter factors. The opportunistic aspect of the business accordingly has been stressed, and several leading dealers either state that there cannot now be said to be a seasonal shift of paper, or else emphasize seasonal requirements for funds on the part of certain sections rather than seasonal placements of paper.

Types of purchasers.—Sales are made to several types of purchasers.

Banks in the larger financial centers buy either for their own account or for the accounts of correspondents. Country banks also buy a considerable amount direct from the commercial-paper houses, while corporations and insurance companies buy a small amount of paper.

Sales to corporations are very small in the aggregate. All data received, both actual percentages and estimates, do not place them at over 1 or 2 per cent of the total volume of sales. Their purchases, notes one dealer, are confined to periods when their business is dull, although another dealer states that, owing to the high rates, quite a number of corporations have been buyers of paper during the last two years as an investment for surplus funds. His estimate of the total proportion of such sales, however, agrees with the figures just given. Sales to insurance companies are very rare, due to the fact, states one dealer, that most of them are not permitted by charter to purchase paper.

Normally, banks in the larger financial centers purchase a considerable volume of paper for their own account. They also purchase a large amount of paper for the account of correspondents, particularly in New York, Boston, Philadelphia, Chicago, and St. Louis, although the amount normally so purchased is stated to be less than for their own account. During the last two years, however, these banks have practically been out of the market on their own account, although New York City institutions again commenced purchasing toward the end of June, 1921. Outlying banks in these centers (small banks scattered through the residential and suburban districts) have bought some paper for their own account. The great bulk of sales during the past two years have thus been made direct to country banks. High rates have proved attractive to them, and the business is said to fall off usually to a great extent when rates are under 5 per cent. In fact, it is generally said that in times of "easy" money large city banks are the chief buyers, and in times of "tight" money, smaller country banks. Commercial-paper houses thus maintain a force of so-called country-bank salesmen, and also do a large volume of business by circular letter. One dealer believes that "country banks are more and more purchasing paper on their own account, and are not depending upon the city institutions or their correspondents to supply their demands." This factor may, he suggests, "more than anything else, have caused the opening of branch offices by the larger brokers in all the various sections."

Some figures have been obtained as to normal and recent percentages which sales to the several types of purchases are of total sales. One dealer estimates that in ordinary times banks in the larger centers, such as New York, Boston, Philadelphia, Chicago, St. Louis, Kansas City, San Francisco, and Seattle, absorb 60 per cent of all paper offered, but

doubts whether they have been in a position during 1919 and 1920 to purchase 10 per cent of the total paper sold. Another dealer estimates that at the opening of this year 90 per cent of his outstanding paper was in country banks. Actual figures supplied by one middle western and one southwestern office show a range of percentages at present as follows: Sales to local banks for own account, 35 to 45 per cent; to local banks for account of correspondents, 21 to 25 per cent; to corporations, 0 to 2 per cent; and direct to country banks, 34 to 38 per cent.

Terms on which paper is sold.—Paper is sold on a varying option, the thought being to give the purchaser an opportunity properly to check the credit. The most frequent option is 10 days; that is to say, the purchaser may return the paper at any time within 10 days. City sales, however, may be made in certain cases only on 5 days or weekly option. One dealer usually allows only 7 days, and another has the "majority and average" of his sales at from 7 to 10 days, while a third has by far the largest portion on 7 days' option. The last named usually allows the 10 days to banks at a greater distance from the chief centers, because of the additional time required to receive replies to mail inquiries. For a similar reason the usual option given by many houses to Pacific coast purchasers is 20 days. A small proportion of the sales carry no option. One dealer states that "firm" sales predominate in New England, while another states that no option is required in the occasional cases when a bank repurchases the obligation of some concern on which they have an up-to-date file.

Payment by the purchaser is generally made either by cashier's check in the case of local banks or by exchange on the center in which the dealer is located or on another leading center, such as New York, Chicago, or St. Louis, in the case of out-of-town banks to whom paper is sent. At times the purchaser's correspondent in the dealer's center is instructed to pay the dealer. A great deal of paper, states one house, is forwarded by the dealer to country banks through the latter's city correspondents, in which case the dealer receives cash on the day of the transaction, and the city bank charges the country bank's account with the amount of the paper. Another dealer thus states that he aims to secure New York, Chicago, or Boston delivery and payment wherever possible.

Several dealers complain that there has been a tendency in the past for country banks when making remittance to calculate the discount from the day on which they receive the paper, instead of the day on which the dealer receives the funds. When this is done the dealer loses the use of the funds for a period equal to the mail time between the bank and himself. Dealers who have commented on the practice, however, agree that it is tending to disappear.

III. Open-Market Borrowing.

Seasonal appearance of paper.—While a considerable number of borrowers are more or less continuously in the market, a considerable number of lines borrow only for seasonal needs. Their paper thus appears in the market at certain seasons of the year only. Manufacturers, *e.g.*, need to purchase raw material for next season's business. More or less regular maturity dates are also found. The underlying theory is that maturities should be based upon anticipated collections, which then provide the means of retiring the paper, and thus render it liquid. These industries then have an annual clean-up, which frequently precedes the period at which regular annual statements are made for the particular industry in question. The maturity of the paper thus depends upon the quickness of turnover, and in the case, *e.g.*, of wholesalers, also upon the length of the terms which they themselves extend. Southern jobbers thus usually sell on longer time and make longer maturities than jobbers in other sections, while department store and grocery paper is usually short. As opposed to the needs of borrowers, another factor which, on the other hand, must also be considered, is the demand of banks for balanced maturities.

A great variety of illustrations of seasonal borrowing has been given. Concerns in agricultural sections dealing in certain commodities which can be purchased only when the product comes to market usually have the peak of their indebtedness two or three months after the first movement of the crop. Such borrowers collect their money, states one dealer, in the three or four months prior to the close of their fiscal year, as they either sell for cash or on very short time the product which they have accumulated during the season when it moves to market. Cotton paper normally begins to appear in September and October and is paid off by March, April, and May. Southern cotton-mill paper usually runs from about October to July, and northern cotton-mill paper chiefly from November to August. Grain dealers in general borrow, it is stated, from September to January, and liquidate about July, generally making statements as of June 30 or August 30. Tobacco manufacturers' paper, states one dealer, usually comes into the market in the late fall and early part of the year, and matures in June and July, while wool paper is outstanding from about June until February. Cottonseed oil crushers and refiners, packers of fruits and vegetables, manufacturers of beverages from fruit juices, and crushers of flaxseed and refiners of linseed oil also are seasonal borrowers. A similar situation prevails with respect to certain manufacturing industries. Clothing manufacturers, shoe manufacturers and jobbers, and glove manufacturers, *e.g.*, sell on

certain datings for the fall and spring seasons, and adjust their maturities accordingly. Agricultural implement manufacturers' paper appears from January to July, and is retired in October, November, and December.

Sectional popularity of paper.—Paper of certain industries is more popular in some sections of the country than in other sections. There are two conflicting forces at work in the case of the individual banker in determining the industries whose paper he will purchase. On the one hand, there is a desire for diversification which impels him to purchase paper of industries other than those found locally. Banks in the crop-moving sections may hold other paper at crop-moving time in order to spread their risks. On the other hand, there is the fact that he is acquainted with industries found locally and thus in a better position to judge the paper of firms in these industries. The latter is by far more potent, and it is therefore easier to place paper of certain industries in localities where they are well known.

Perhaps the most conspicuous illustration is afforded by lumber paper, which is not popular in the East and has a very limited market there, but is found more largely in Chicago and the Northwest, where it sells readily. There is, however, some in New England. Similarly, cattle loan paper has a market in the West, but meets with little favor in the East. To a lesser extent this is true also of grain paper, states one dealer. Again the South likes cotton paper, which is not appreciated by the East. Tobacco paper is especially popular in the South, and, "as a matter of fact," states one dealer, "all over the country." On the other hand, paper of commission merchants, textile manufacturers, etc., is far better known in the East than the West. New England mill paper is more popular in New England, where it is a legal investment for savings banks in Massachusetts. Certain buyers, states one dealer, do not like the paper of corporations located at too great a distance, and this tends to confine the sale of paper of medium-sized concerns to a great extent to the sections where they are located. Smaller names, in fact, generally sell better locally, although in the case of large firms no difference is noted. At times also a firm may not wish its paper offered in the immediate vicinity of the city where it is located, due either to pride on the part of a small firm in the fact that it obtains its funds outside or to a desire to prevent other local parties from obtaining data about its business.

The open-market borrower.—It is often stated that the minimum capital of the firm which borrows in the open market is about \$200,000. At the present time, however, state several dealers, it is very difficult to sell the paper of the smaller borrowers. One dealer whose normal

figure is the above, remarks that at present \$500,000 would be about correct. Another dealer observes that "generally speaking, we would say that the big corporations have liquidated more slowly than the smaller firms and that we have outstanding in the market to-day larger amounts of big corporation paper and comparatively little paper of the smaller borrowers." The minimum figure which is given naturally varies somewhat with the individual dealer. Some show a higher amount, namely, \$250,000 to \$300,000 and \$500,000 (with infrequent exceptions reported by one in the case of local borrowers). One dealer, however, places the figure for capital investment as a rule at \$700,000, while several show an amount as small as \$100,000. One dealer observes that, while very little paper could probably be sold now for borrowers with less than \$200,000, before money became firm, paper of borrowers of, "say, \$125,000 or \$150,000 quick in stable lines could be sold." It is interesting to observe that one dealer distinguishes between wholesalers and jobbers on the one hand and manufacturers on the other hand. While the \$200,000 minimum holds in his opinion for the former, for the manufacturer "the minimum must necessarily be a larger amount, as he always has a large portion of his capital tied up in plant and equipment."

Control of the amount borrowed.—The statement is often made that the commercial paper dealer so facilitates borrowing in the open market in normal times as to render it possible for many houses to borrow very heavily in proportion to their capital. On the other hand, almost all commercial paper dealers in the present study call attention to efforts which they make to keep the volume of paper issued by the individual borrower within reasonable limits. They endeavor to see that the borrower has sufficient bank lines open to take care of his open-market borrowings. This, of course, has the effect of preserving the liquid character of the paper from the point of view of the individual purchasing bank, in the event that new paper is not sold. "A good broker," states one dealer, however, "can always sell some paper."

These reserves of unused borrowing power are of particular importance in the case of steady borrowers, as the borrower cannot depend upon anticipated collections to retire paper. One hundred per cent, of course, is ideal, and in certain cases the dealer may not be in a position to require it, but several dealers specify as much as 50 or 75 per cent. A dealer states that he has arranged additional bank lines for clients whose own lines have been insufficient.

One dealer, however, states that "we very seldom have occasion to limit the borrowings on the open market or through banks, of any of our clients; however, we keep in close touch with them, and advise

as to what we feel is the proper course to be pursued." The dealer, of course, follows closely the condition of his borrowers, which one dealer states that he does through monthly statements or personal interviews, and thus at all times knows the total indebtedness of his accounts through all sources.

The effort to keep sufficient bank lines open reflects a belief that, as one dealer expresses it, "the open-market facility should be used collaterally and not in addition to the bank-line facility." As another dealer states, it is desired to have the open market used only when the borrower is not using his bank; "in fact the open market is to be used in order to clean up his accommodation at his bank and he is to stop using the open market when he starts borrowing from his bank—in other words, to alternate between these two borrowing channels. Of course, during the past year it has been impossible for the borrower to live up to this condition on account of the unforeseen cancellations which necessitated carrying over an abnormal amount of inventory.

IV. Character of Paper Sold.

Form of paper.—There are four classes of paper which appear in the open market. Unsecured single-name paper is most frequent. Double-name paper is of two kinds—either trade paper, *i.e.*, promissory notes given in settlement for goods purchased and indorsed by the seller, or nontrade paper bearing indorsement. Some collateral notes are also used. Estimates differ as to the proportion of the total volume of paper in each of these forms. The proportions vary to some extent with the character of the individual business. The question is complicated by the fact that some dealers regard paper with the indorsement of directors or officers as single-name paper, whereas others regard it as double-name nontrade paper. Thus, one broker estimated that "unsecured single-name paper constitutes approximately one-half of the total handled by brokers," and two others placed the figure at 65 per cent, while, on the other hand, two large dealers stated that 95 per cent and two others that almost all their paper was in this form. The general figure is probably somewhere between these two extremes, and one dealer has placed it at 75 per cent.

The general consensus of opinion is that double-name trade paper does not constitute over 5 per cent of the total volume. The highest estimate, which was given by two dealers, was 5 per cent, and most of the reporting houses stated that they either handle none or almost none, or a very limited amount. One dealer adds that "we believe the commer-

cial paper market should be made available only for strong borrowers who, by reason of their size and strength, enjoy a single-name credit."

Estimates of the proportion of double-name nontrade paper differ somewhat. Two dealers who showed lower figures for single-name paper have a rather high figure, namely, 30 to 35 per cent, but other estimates place it at 10 and 15 per cent, and several other dealers state that they themselves handle but little of such paper. "The only prominent class of indorsers of paper," states one dealer, "are the commission houses, who indorse or guarantee the paper of textile mills for whom they sell." He notes that the commission houses, especially in New England, make no financial statements. This paper is stated to be distributed somewhat differently than the other types of paper. Another dealer states that indorsement is found largely in the case of small closed corporations, where the officers or directors individually will indorse.

The use of collateral notes is stated by some dealers to be very limited, while several estimate the amount at about 5 per cent of the total volume, and one places it at 10 per cent. Savings banks in New England often purchase collateral loans. One dealer states, however, that he does not believe that on the whole a great deal of collateral paper is sold in the East, but there is a large business in the South and West in cattle and cotton paper, and throughout the country considerable paper of large cold-storage warehouses secured by warehouse receipts is sold, although such paper is usually distributed close to its source. The great majority of warehouse paper, however, will be placed direct with banks and not pass through the commercial-paper house, as it is necessary that the warehouse receipts be readily available to the maker. In general, collateral will consist of securities, stocks or bonds, either listed on one of the exchanges, or well known locally, although instances of cotton warehouse receipts, chattel mortgages on cattle, and installment notes are also reported. One dealer states that this paper is largely of individuals, although some is of stock exchange houses. The margin generally specified against listed security collateral is 20 per cent, although 25 and 30 per cent are also noted. Two dealers who refer to other classes of collateral state that the margin varies from 10 per cent to 100 per cent, according to how well known and marketable it is. The dealer in almost all cases looks to the maintenance of a satisfactory margin, although, states one dealer, he is not legally obligated to do so. One dealer, however, states that in the case of collateral loans some banking institution has generally been designated as trustee, and the purchaser accordingly expects very little of the commercial-paper house in the way of watching the margin.

In almost all cases, the maker is also the payee, and the note reads:

"Pay to the order of ourselves." The note is then indorsed in blank by the maker. This is the case both with single-name paper, double-name nontrade paper, and collateral notes. By this means the notes are rendered negotiable, and the dealer avoids indorsing them. He guarantees only the genuineness of the signature.

Registration of paper.—Following the panic of 1907, registration of paper was often advocated as a means of safeguarding purchasers by giving definite knowledge as to the amount of paper outstanding. In 1911 one of the New York trust companies made arrangements for registering paper, and other prominent financial institutions announced the inauguration of similar facilities, but the service has only been availed of by a few borrowers.

Denominations.—It is generally agreed that the greater part of the paper is in \$5,000 denominations. The estimates of the percentage of the total paper outstanding in normal times which is in this denomination range from 50 to 75 per cent. The next most frequent units are \$2,500 and \$10,000. The percentage estimates which have been received generally place the proportion of the former as considerably greater than the latter, although two houses regard the normal percentage as approximately equal in the two cases. Some houses state that the proportion in denominations in excess of \$10,000 is very small, although several show a considerable percentage, the units specified being \$25,000 and \$50,000, and by some dealers also \$100,000 and \$500,000. One dealer states that "when we get large blocks of paper from any one concern, we often receive large denominations, running as high as \$25,000 or \$50,000," while another notes that "the denominations are to fit the case of a bank where it can only lend a certain percentage of capital and surplus to any one name."

During about the last two years the normal percentages have been very much altered. This has been due to the fact that the great bulk of sales during that period have been made direct to country banks. The dealer adjusts the denominations according to the current requirements of buyers, considering whether the large city or the smaller country banks are buying. A much larger proportion of notes are therefore at present in \$2,500 denominations, while denominations larger than \$10,000 have correspondingly declined and the proportion of \$10,000 pieces is also stated by some dealers to have declined. The greater use of the \$2,500 denominations has added considerably to the dealer's expense of doing business.

Maturities.—Reports received indicate that the majority of paper has a maturity of six months. Some dealers, however, show a lesser average or customary maturity, in some cases four and in some cases

five months, while others give the customary maturity as from three to four, four to six, and five to six months. The shortest maturity shown was two months, this dealer also stating that in very easy money markets he has sometimes sold paper, in exceptional instances, as long as eight or ten months. Two dealers note a tendency toward shorter maturities under present conditions. One states that the majority of his notes now run from four to six months and under normal conditions from five to six months, while the other states that he takes a much larger percentage of three months' notes than formerly and a smaller percentage of six months' notes. "Variations in maturities are occasioned," states one dealer, "by the nature of borrowing and by interest rates. In an easy money market, six months' paper usually predominates, as the borrower has only to pay two commissions a year. In a tight money market, four months' paper predominates, for the reason that the buyer needs only to carry the paper about 30 days before it is rediscountable at the Federal Reserve Bank, and most buyers of paper, during periods of tight money, wish to have quickly realizable investments. Seasonal lines of business usually borrow for six months, with a renewal of three or four months." If there is a tendency toward cheaper rates, however, banks naturally buy as long maturities as possible, while the reverse is the case if there is a tendency toward higher rates. Most dealers who have considered the matter state that there is little variation in length of maturities, according to the line of business of the maker.

Paper is not renewed except in periods of stress. Savings banks, however, it is stated by one dealer, will renew paper indefinitely. Instead, new paper may be sold to replace current maturities, and thus the liquid character which such paper possesses for the individual holder is preserved. In actual practice, however, the proportion of paper which is replaced by other paper appears to be high. Two dealers estimate that about 50 per cent is replaced, while another places the figure at 75 per cent, but states that the number of replacements varies very greatly with different lines of business and different market conditions. The latter states that in the case of nonseasonal lines "there might, under ordinary market conditions, be no limit to the number of 'renewals' granted, provided, of course, that the concern in question keeps its affairs in a good liquid condition with a good proportion of quick assets to debt at all times."

V. Rates.

In the present study no effort has been made to consider the relation between open-market rates and rates charged customers by banks. Instead, attention has been confined to differences between commercial-

paper rates themselves and to the method followed by the dealer in taking the paper from the borrower.

Differences between markets.—A number of dealers state that no considerable variation is found, and point to the fact that they offer their paper at the same rate in all markets. On the other hand, certain differences have been indicated by other dealers. These in general, however, do not exceed one-half of 1 per cent. Some markets buy more freely at certain seasons of the year, and thus in the Middle West after crop-moving time the dealer may be able to place paper at a trifle lower rate, but the difference, states one dealer, will not exceed one-fourth of 1 per cent. One dealer states that at times in the past the coast market has been for quite sustained periods, one-fourth to one-half per cent below the eastern markets, while at times the New York market has been for very brief periods substantially below other markets, although this is exceptional. Another dealer observes that when rates are high New York as a rule is "at the top," while when rates are low it is "at the bottom." Several dealers note a tendency for changes in rates to move across the country in a regular wave from east to west, the latter being affected two or three weeks after the New York market has been, although one observes that this is not invariable.

Difference between lines of business.—Some differences in rates between different lines of business have been reported. Certain lines and short maturities, state several dealers, at times command a rate lower than the general market rate, this being true of lines which can be quickly liquidated. One dealer believes that as a general proposition a few staple lines, such as groceries, dry goods, and hardware, probably sell at a somewhat lower rate. Several dealers agree that certain New England mill paper, bearing commission-house indorsement, commands a lower rate in markets where it is sought after, while a middle western dealer states that this is the case also with grain paper secured by registered terminal warehouse receipts. On the other hand, states one dealer, certain lines do not always command a ready sale, in particular luxury lines, such as automobiles, jewelry, and pianos. On the whole, however, dealers state that differences are found rather with respect to the individual borrower, or, as one dealer expresses it, the matter is "purely a question of credit combined with supply and demand." The rate is then determined by the strength of the borrower, usually, remarks one dealer, from the standpoint of high indebtedness to total resources, and by the infrequency with which the name comes into the market. It is stated that "no general rule is possible applying to most single-name paper. Some of the very large and nationally known names frequently bear a lower rate than others in the same line of business, the latter not

being so strong or so well known. When the market is broad and paper moving readily there is frequently a spread of one-half of 1 per cent in rates, depending both on the class of paper offered and the excellence of the concern's statement." Another dealer states that the "spread" has been greater during recent months.

Outright purchase versus consignment business.—It is generally stated that most commercial paper is purchased outright by dealers, who then resell it as occasion offers. This is on the whole confirmed by the present study. The dealer then purchases the paper outright at a flat rate, less also his charge for handling or "commission," as it is called, and "takes his chances" on being able to resell at a profit. If rates decline, he gains, but if they increase his margin decreases and may disappear. The borrower receives payment at once from the dealer when he delivers the paper to him. But some exceptions to the practice are found, and these appear to be more frequent than has generally been believed. One large dealer states that he "endeavors to avoid speculation in paper, and thus tries to buy so that the account will protect him against changes in rates." He, however, places the funds to the credit of the maker at once, and merely makes an adjustment in case the rate changes. Another large dealer states that he purchases fully 90 per cent of his paper on an "open-rate" basis. The dealer then deducts an approximate amount to cover interest, as well as the commission, and remits the net amount to the borrower immediately on receipt of the paper. He states that his customers are perfectly willing for him to protect them in an advancing market, as he is to protect them in a declining market, and cites the fact that about the opening of May, *e.g.*, he saved his customers considerable money on unsold blocks of paper which he had on hand.

One dealer states that some dealers may retain, *e.g.*, 10 per cent to be paid only when the paper is actually sold. Regular consignment business, however, apparently relates rather to cases in which the dealer makes no advance at all to the borrower, instead of cases in which the rate merely is left open, but the paper paid for at once by the dealer. The volume of such business which is reported is, however, small. One dealer states that "most brokers occasionally take paper on consignment—for instance, when a borrower may not be in immediate need of funds, but does desire to take advantage of any sales that can be effected on the open market, frequently for the purpose of reducing borrowings at the borrower's own banks, or in a particularly slow market, piling up money in advance of actual requirements." This dealer states that "in a steadily advancing market, or when the market is very dull and very little paper is moving, we sometimes make advances

of a round amount against a block of paper, remitting the balance to the borrower as the paper is sold." In a few instances, where the maturities are exceptionally short, he charges the borrower a net rate of interest without commission, which sometimes brings the profit a trifle under the customary one-fourth of 1 per cent.

The dealer's commission.—The customary commission which the dealer receives for his services has been one-fourth of 1 per cent for many years, and is made irrespective of the maturity of the paper. This is still charged by the majority of the houses. Last year, however, the increased cost of doing business attendant upon the increased distribution to small country as against large city banks caused several dealers to raise their charge to one-half of 1 per cent. One dealer is stated to have done this only in the case of the poorer risks, the charge to the better risks remaining at one-fourth of 1 per cent. One dealer states that the same result has been achieved in some cases by insisting upon three months maturities, instead, as heretofore, taking four, five, or six months paper. Another dealer states that he has heard of cases during the past year where the dealer who has acted more or less as a banker for a client, owing to his inability to dispose of the paper, has charged a larger amount to compensate him for tying up his own money in order to take care of his client.

VI. Operation of the Individual Commercial Paper House.

Buying and selling paper.—Paper is often purchased only by the principal offices, in particular New York and Chicago, and Boston in the case of houses whose head office is located there. Certain houses also permit offices covering other sections, such as St. Louis and San Francisco, to purchase paper, but such purchases are subject to the approval of the head office as to amounts, names, and rates. As a general rule the staff engaged in purchasing or soliciting new accounts is small as compared with that engaged in selling, and men are shifted from the one task to the other as occasion requires. When money is easy, say about 4 per cent, states one dealer, he shifts men from selling to getting new accounts, while when money is tight the reverse will be the case.

Stocks of paper are generally carried at the principal offices, and in some cases also in San Francisco, although smaller stocks may be carried at some of the lesser offices. The purpose is to provide the maximum service to buyers and to deliver paper with as little delay as possible. The centers in which stocks are carried correspond in a broad way to those which purchase paper. In one case, however, it is stated that the Philadelphia stock is carried in New York, owing to the small

distance between the two centers. One dealer states that some branches may sell local paper locally without passing it on to New York or Chicago. Another dealer sometimes takes paper from his affiliations and carries it himself in order to render it immediately available for delivery in his own market, while in other cases he takes it merely to fill orders as they are received from his purchasing banks.

Where houses employ correspondents to some extent, reciprocal arrangements for taking paper from each other exist, and the profit is divided on paper sold through correspondents. One dealer states that "one office may buy outright from another office that originates the paper, take a block on consignment, or buy as it sells the paper. In the last case, an option is usually granted by one office to the other "covering the option that by necessity is granted to the bank purchasing the paper." Where several separate dealers are employed by an account, each generally has a clearly defined territory within which he will sell the paper, and the borrower deals with each entirely independently of the other. The dealer, however, is advised of the total borrowings, both in the open market and from bankers.

Financing the business.—Most dealers state that the rate of turnover of their own capital varies so greatly from time to time that no estimate can be given. On the other hand, estimates were given by several dealers. One gave the figure as 40 to 50 times per annum, another as roughly 50 times (based upon the capital used in the commercial paper end of his business. A third gave the figure as 100 times, a fourth stated that it varied from 50 to 100 times, and a fifth placed it at about 150 times. One dealer explained the range as probably found in the case, on the one hand, of dealers buying paper outright, who turned their capital over 50 times, and, on the other hand, of dealers taking paper on consignment, who turned their capital over 100 times.

An indication was also obtained from several dealers of the relative proportion which their borrowing from banks bears to their own capital. One stated that the greatest part of the funds used to carry paper was obtained from his banks, while another smaller house, however, stated that fully half the time it carries paper without obtaining loans. Two dealers furnish more definite estimates, one stating that his borrowings varied from three to six times his own capital, depending upon market conditions, while another stated that during the abnormal conditions prevailing during the past year or so, his borrowings were two to three times his own capital. One dealer, who stated that conditions varied greatly from time to time, cited the fact that when he believed it advisable, he curtailed his purchases of paper and might loan on call or buy bankers' acceptances.

The number of important bank accounts carried and the number and location of centers in which the dealer borrows depends in most cases upon the number of centers in which he purchases and keeps stocks of paper. Thus, some houses, states one dealer, may have 30 to 40 accounts. In general, these offices borrow the funds required from the local banks, principal borrowings, of course, being in the larger centers. The balances which are kept in the smaller centers in certain cases become mere working balances, remittance being made from these centers for the paper bought. Some dealers, however, borrow only in the center in which their head office is located, while one dealer who does this also at times arranges loans in another center through the head office.

The commercial paper house in most cases uses the paper which it holds, whether it owns the same or has merely made an advance against it, as collateral for the loans which it obtains. In some cases stocks and bonds are also used as collateral, but, except in the case of one dealer, to a far lesser extent. One dealer states that he may borrow on securities in the case of a time loan, in order to avoid substitutions, or on commercial paper in the case of a demand loan. A small proportion of borrowings are unsecured in the case of several houses, "usually with the same banks who give us lines against our paper," states one dealer. Some banks do not ask for any margin, while other banks request 10 per cent and to a lesser extent 5 per cent. One dealer states that banks are now "overzealous in the matter of margins." The margin on mixed collateral, states one dealer, is 20 per cent, and another dealer in general gives this margin on commercial paper also, although it is not required. It is stated that the banks do not request dealers to keep average balances, as in the case of ordinary commercial borrowers, although the dealers endeavor to keep fair balances. Several dealers, however, give required percentages as 10 and 20 per cent, and one from 10 to 25 per cent. "Loans made to a commercial paper broker," comments one dealer, "are generally of short duration, and are much sought after by banks." Another dealer states that he borrows chiefly from banks in which he carries no deposits.

The form of Trade Acceptance recommended by The American Acceptance Council for general use.

New York, N. Y., August 15, 1918 <small>(CITY OF DRAWER) (DATE)</small>		DATE August 18, 1918 PLACE New York, N. Y. NAME OF BANK First Nat'l Bank	PAY TO THE ORDER OF OURSELVES ACCEPTED DOLLARS (\$ 850.00)
ON October 15, 1919 <small>(DATE OF MATURITY)</small>			
Eight hundred and fifty <small>(AMOUNT IN FIGURES)</small>		TO John Doe & Son <small>(NAME OF DRAWEE)</small> 1433 Adams Street <small>(STREET ADDRESS)</small> Boston, Mass. <small>(CITY OF DRAWER)</small>	BY Richard Roe & Co. <small>(SIGNATURE OF DRAWER)</small> BY Richard Roe

Some authorities have suggested that the word "Maturity" being in conformity with original terms of purchase" be inserted following the word "Drawee" where it first appears in the above form, the purpose being to guard against the use of the trade acceptance in settlement of past due accounts. It should be remembered that trade acceptances are to be used in connection with current transactions only.

Suggested Readings on Chapter VI.

- Pamphlets of American Acceptance Council.
- Acceptance Bulletin (monthly).
- Phillips, C. A.—Bank Credit, Chapter XVI.
- Dewey, D. R., and Shugrue, M. J.—Banking and Credit, Chapter XXVI.
- Moulton, H. G.—Financial Organization, Chapter XXI.

Questions and Problems on Chapter VI.

1. Indicate how the supplies of capital in various sections of the country are equalized under a branch-bank system.

2. The notes of the Chicago packers were early sold to the Iowa banks. Explain why these transactions could be carried on easily.

3. Outline the credit problem of a bank purchasing notes from a note broker.

4. Explain the device used to protect the dealer against changes in the discount rate in the time between the purchase and sale of the acceptances.

5. On a day when the buying rate for 60-day acceptances was $3\frac{5}{8}$ per cent and the selling rate $3\frac{1}{2}$ per cent, the call rate for loans with acceptances as collateral was 5 per cent. Assuming no changes in the rates, how long could the dealer hold acceptances purchased with call money and still make any profit on the transaction?

6. Calculate the gross profit from discounting \$1,000,000 of bankers' 60-day acceptances at $3\frac{5}{8}$ per cent and selling them at a discount of $3\frac{1}{2}$ per cent after 10 days.

7. From the *Monthly Review of the New York Federal Reserve Bank* get figures for the amount of commercial paper outstanding since 1918. Make a graph of these figures and the total loans of the selected list of the member banks given in the *Federal Reserve Bulletin*. What relation is there between the two curves?

8. Suppose you were planning a concern to deal in commercial paper on a national scale. Draw up a list of cities in which you would put branch offices. Indicate whether the branch would be primarily one which purchases or sells paper. Justify your designation by reference to the industries, and financial conditions of the communities.

9. Why should business corporations and insurance companies invest in commercial paper? How would it compare with Government bonds for the purpose?

10. Why should country banks buy more paper when money is "tight" than do the city banks?

11. What determines the type of paper which will be most popular in a given region?

12. What difficulties would be encountered in dealing with notes secured by collateral?

13. What effect does ease or tension in the money market have on the duration of the paper?

14. What would be the gross receipts from handling \$3,000,000 of commercial paper?

15. A national bank accepts a draft for a customer and then sells it for him. Is there anything objectionable in the procedure?

16. A commercial-paper dealer has a capital of \$1,000,000. He turns it over 50 times a year. What would be his gross receipts?

CHAPTER VII.

CLEARING.

The primary function of the clearing house is to offset debits and credits and pay only balances. In earlier times each bank collected the checks it received on other banks by means of messengers. This took considerable time and involved the risk of loss. Now the checks are all brought to one place and exchanged. Each bank is credited with the checks which it brings and debited with the checks presented to it. Part of the banks owe balances and part have balances due them.

Methods of Settling Clearing House Balances.

1. With cash. The debtor banks bring the cash to the clearing house before a certain time, and the creditor banks go to receive it. This involves trouble and the possibility of loss.
2. With managers' checks on debtor banks given to the creditor banks. In times of easy money, checks are cleared the next day. The creditor banks may present them and get the cash.
3. With balances borrowed from creditor banks. In this case, interest is paid for the use of the balances.
4. By special-order gold certificates, used only in settling balances.
5. By adjustments on the books of the Federal reserve bank or its branches, crediting some and debiting the others.
6. By drafts on another city, say New York.

Clearing Houses in Time of Panic.

1. Clearing house loan certificates. These are issued to banks in difficulties, upon the deposit with the clearing house committee of suitable collateral. They may be used to meet debit balances at the clearing house banks.
2. Clearing house notes. These instruments are issued to

supply the need for currency. They are backed by all the clearing house banks.

Clearing as a Business Barometer.

Statistics collected by the Federal Reserve Board concerning debits to individual accounts are far superior to clearing, as a business barometer. Clearings are an indication of business activity, but in using them, certain cautions as between different places and different times should be observed.

Cautions between places.—

1. Do clearings include the same items or does the city pad its clearings?
2. Is banking equally concentrated? A city with a few big banks will conduct a given volume of business with a smaller volume of clearings.
3. Is the proportion of interbank checks to the total checks drawn the same?

Cautions between different times.—

1. Variations in the price level change clearings without changing the volume of business.
2. Have there been changes in business practices or in banking conditions? Consolidations tend to lessen clearings. The clearing system of the New York Stock Exchange has eliminated the use of many checks.

Other Activities of Clearing Houses.

1. They set maximum rates paid to depositors.
2. They fix uniform rates of exchange and collection.
3. In a few cases, they regulate the minimum rates charged to borrowers?
4. They control the advertising policy of the banks.
5. They maintain clearing house examinations.

Advantages of Clearing House Examinations.

1. The examiner can consolidate the records of all of the banks and discover the persons who are overborrowing by getting accommodations at more than one bank.

2. The examiner can bring pressure to correct unsound banking which does not violate any law and consequently cannot be reached by State or national bank examiners.
3. The examiner can judge of the worth of the paper because he can know of the credit standing of the debtors.

Objections to Clearing House Examinations.

1. Banks fear that their competitors will get too much knowledge of their affairs.

Materials on Chapter VII.**Clearing Houses.**

Adapted from J. G. Cannon, Clearing Houses (1910), pp. 1-2, 137-140, 148-149, and 190-200.

What is a clearing house? The Supreme Court of the State of Pennsylvania has defined it thus:

It is an ingenious device to simplify and facilitate the work of the banks in reaching an adjustment and payment of the daily balances due to and from each other at one time and in one place on each day. In practical operation it is a place where all the representatives of the banks in a given city meet, and, under the supervision of a competent committee or officer selected by the associated banks, settle their accounts with each other and make or receive payment of balances and so "clear" the transactions of the day for which the settlement is made.

But we must go farther than this, for though originally designed as a labor-saving device, the clearing house has expanded far beyond those limits, until it has become a medium for united action among the banks in ways that did not exist even in the imagination of those who were instrumental in its inception. A clearing house, therefore, may be defined as a device to simplify and facilitate the daily exchanges of items and settlements of balances among the banks and a medium for united action upon all questions affecting their mutual welfare.

The clearing houses in the United States may be divided into two classes, the sole function of the first of which consists in clearing notes, drafts, checks, bills of exchange, and whatever else may be agreed upon, and the second of which, in addition to exercising the functions of the class just mentioned, prescribes rules and regulations for the control of its members in various matters, such as the fixing of uniform rates of exchange, interest charges, collections, etc.

Clearing houses may also be divided into two classes with reference to the funds used in the settlement of balances: First, those clearing houses which make their settlements entirely on a cash basis, or, as stated in the decision of the Supreme Court above referred to, "by such form of acknowledgment or certificate as the associated banks may agree to use in their dealings with each other as the equivalent or representative of cash"; and second, those clearing houses which make their settlements by checks or drafts on large financial centers. . . .

Clearing-House Bank Examiners.

In the first edition of this book, published some nine years ago, the writer strongly advocated the appointment, especially by the stronger

clearing houses of the country, of clearing-house bank examiners, whose duty it should be to make periodical examinations of each bank member of the associations with which they were affiliated, as a desirable means by which to reduce to a minimum the number of bank failures due to mismanagement and bad judgment.

This recommendation was in no wise intended as a reflection upon the examinations pursued under national and State authority. The national and State officers are limited in their powers of criticism to actual infringements on the law, and before they can take steps to correct such infringements capital has often become impaired and failure is threatened.

Most bank failures are due to the gradual acquirement of undesirable assets over a period of years, and if some authority exists with power to make recommendations of a remedial character, with the further power to enforce such recommendations, if necessary, there is little doubt that many bank failures would be averted.

The panic of 1907 presented many striking examples of just what is intended to be emphasized in this chapter, viz.: that under the careful supervision of a competent and reliable examiner many of the assets of the failed banks, upon which it was impossible for them to realize at a time when they needed their funds, would probably have been liquidated upon his recommendation and advice long before the necessity for such liquidation had arisen.

Mr. J. B. Forgan, of Chicago, has recently said on this subject:

A competent examiner—and there are many such now in the government employ—while he cannot pass judgment on all the loans in a bank, can, after a careful examination, or a series of examinations, form a wonderfully correct judgment as to the general character of its assets and as to whether its management is good or bad, conservative or reckless, honest or dishonest. Examinations, as they are now conducted, have a most beneficial influence on bank management, especially by way of restraint. The correspondence carried on by the Comptroller, based on the examiners' reports, does an inestimable lot of good in the way of forcing bank officers to comply with the law and in compelling them to face and provide for known losses as they occur. Supervision by examination does not, however, carry with it control of management and cannot, therefore, be held responsible for either errors of judgment or lapses of integrity. Examination is always an event after the act, having no control over a bank's initiative, which rests exclusively with the executive officers and directors, and depends entirely on their business ability, judgment, and honesty of purpose.

The clearing-house association of Chicago was the pioneer in the establishment of an independent system of clearing-house bank examinations in this country, its system having been inaugurated on June 1, 1906, with results that have, to the present time, more than fulfilled the

expectations of the bankers of that community. The chairman of the clearing-house committee, speaking in this connection only recently, said:

The result of our experience in Chicago is most satisfactory and gratifying. The banks have almost unanimously adopted every suggestion made by the clearing-house committee for their betterment and strength. In several instances the committee, from its wider knowledge of the financial situation, has been able to save some of the smaller institutions from loss by enabling them to take hold of conditions in time. I cannot properly go into such details as would illustrate the effectiveness of clearing-house examinations as we have experienced it, and can only say in a general way that it has been even more satisfactory than I anticipated it would be before it was undertaken.

In substantially his own words the Chicago examiner operates under the following conditions: The examinations extend to all the associated banks of Chicago and to all nonmember institutions. The work is conducted with the aid of five regular assistants, each fitted by experience to do thoroughly that part of the work assigned to him. The examinations include, besides a verification of the assets and liabilities of each bank, so far as is possible, an investigation into the workings of every department and are made as thorough as is practicable. After each examination the examiner prepares a detailed report in duplicate, describing the banks' loans, bonds, investments, and other assets, mentioning specially all loans, either direct or indirect, to officers, directors, or employees, or to corporations in which they may be interested. The report also contains a description of conditions found in every department. One of these reports is filed in the vaults of the clearing house, in the custody of the examiner, and the other is handed to the examined bank's president for the use of its directors. The individual directors are then notified that the examination has been made and that a copy of the examiner's report has been handed to the president for their use. In this way every director is given an opportunity to see the report, and the examiner, in every instance, insists upon receiving acknowledgment of the receipt of these notices.

The detailed report retained by the examiner is not submitted to the clearing-house committee, under whose direct supervision he operates, unless the discovery of unusual conditions makes it necessary. A special report in brief form is prepared in every case and read to the clearing-house committee at meetings called for that purpose. The report is made in letter form, and describes in general terms the character of the examined bank's assets, points out all loans, direct or indirect, to officers, directors, or employees, or to corporations in which they may have an interest. It further describes all excessive and important loans, calls attention to any unwarranted conditions, gross irregularities, or dan-

gerous tendencies, should any such exist, and expresses, in a general way, the examiner's opinion of each bank as he finds it. . . .

The New York Clearing House.

During a comparatively short period immediately following 1849 the number of banks in New York increased from 24 to 60. In the daily course of business each bank received checks and other items on each of the other banks, which had to be presented for collection. All such items on hand were assorted and listed on separate slips at the close of the day, and items coming in through the mail on the following morning were added at that time. To make the daily exchanges each bank sent out a porter with a book of entry, or pass book, together with the items to be exchanged.

The receiving teller of the first bank visited entered the exchanges brought by the porter on the credit side of his book and the return exchanges on the debit side, who then hurried away to deliver and receive in like manner at the other banks. It often happened that five or six porters would meet at the same bank, thereby retarding one another's progress and causing much delay. Considerable time was consumed in making the circuit. Hence, the entry of the return items in the books of the several banks was delayed until the afternoon, at an hour when the other work of the bank was becoming urgent.

A daily settlement of the balances was not attempted by the banks, owing to the time it would have required, but they informally agreed upon a weekly adjustment, the same to take place after the exchanges on Friday morning. At that time the cashier of each bank drew a check for each of the several balances due it, and sent a porter out to collect them. At the same time the porter carried coin with which to pay balances due by his bank. After the settlement had been made, there was a meeting to adjust differences and bring order out of chaos. . . .

Daily Routine of the New York Clearing House.

The clearing room of the New York Clearing House is a beautiful and commodious apartment, 60 feet square, surmounted by a dome rising 25 feet above the walls. Light enters through the glass forming the upper part of the dome, and, when necessary, additional illumination is secured by the use of electric lights, which encircle the base of the dome. Four rows of desks occupy the floor, with sufficient space between for an easy movement of the clerks in delivering the exchanges. Each member has its own numbered desk, separated from the one on the right and left by a network of wire. At the east end of the room is the manager's

gallery, elevated sufficiently to command an easy view of the scene of operations. It is made accessible in front by steps and in the rear by an elevator.

Each business day, at 10 o'clock, the exchanges take place between the banks. About fifteen minutes before the hour designated the clerks begin to arrive. Formerly it was the custom for each member to send only two clerks, but so numerous and cumbersome have become the exchanges of many of the banks that it is now necessary to send one and sometimes two extra clerks to assist in transporting the items to and from the clearing house and in delivering the packages.

The two essential representatives of each bank are the "delivery clerk" and the "settling clerk." The former delivers the packages brought, and the latter receives the return packages from the messengers of the other banks.

Each member sends its items for the other banks made out separately and inclosed in envelopes, with the amounts listed on the "exchange slip" attached to the exterior. On their arrival at the house the settling clerks furnish the proof clerk, sitting at his desk in the manager's gallery, with the "first ticket," upon which is entered the "amount brought" or "credit exchange," and which the latter transcribes on the clearing-house proof under the head of "Banks Cr." The total of the amounts thus brought by the several clerks constitutes the right-hand main column of that sheet. If each messenger has a package for each of the other banks, there are 2,500 in all to be delivered.

As a fact, in all other respects than the quantity of packages, this is the number of transactions between the clerks, for it is found in practice better to use a blank slip than to omit a slip merely because there is no amount to put upon it. This plan saves doubt and unnecessary searching when looking after the proof. The stationery used by each of the several banks is put up in sets in numerical order, and this is a reason why it is easier to use all the slips than to discard those which happen to have no items. Accordingly, as the delivery clerks pass the desks, as is described farther on, it is the rule to deposit the "small ticket" with the receiving clerk in each case, whether there is a package corresponding to it or not. When the settling clerks come to make their summing up, first checking back by the small tickets, they find that the blank spaces in their sheets are justified by the blank tickets of corresponding numbers, and are in this respect assured of the correctness of their work.

When the hand of the clock points to a few minutes before 10 o'clock the manager appears in his gallery, usually surrounded by a group of visitors. At one minute before 10 he sounds a gong as a signal for each of the clerks to station himself in his proper place. The settling clerks

occupy their separate desks on the inside of the counter, while the delivery clerks form on the outside with the exchanges either on the left arm or carried in a box or case of some light material. The delivery clerks arrange themselves in the consecutive desk order, and stand ready for delivery as they pass along the counter. They carry "delivery clerks' receipts" containing the amounts for each bank arranged in order, upon which the several settling clerks, or their assistants, give receipts for the package delivered.

NEW YORK CLEARING-HOUSE.	No. 61.	New York Clearing-house,
		_____ 1909
	Credit Fourth National Bank, \$	_____
		_____ Settling Clerk.

FORM OF "FIRST" OR CREDIT TICKET.

All are now in position for the exchange. The manager calls "ready," and promptly at 10 o'clock he sounds the gong again and the delivery of the packages begins. He looks down upon four columns of young men moving simultaneously like a military company in step. At the start each advances to the desk in front where his first delivery is to be made. He deposits the package of items and also the receipt slip on which the assistant of the settling clerk (or, in the case of small banks, the settling clerk himself) writes his initials opposite the amount of the package delivered in the blank space provided for that purpose. At the same time, in an opening in the desk provided for that purpose, he deposits a "small ticket" containing the amount of the package. If correct, it must agree with the amount listed on the "exchange slip." This process is repeated at the desks of all the banks, each clerk making the complete circuit in ten minutes to the point from which he started.

Being now at liberty, each delivery clerk takes back to his bank the exchanges deposited by the other messengers, while the settling clerks remain until the proof is made.

The settling clerks, immediately upon the completion of the exchange of packages, sum up, as quickly as possible, the amounts entered on their statements under the head of "Banks Dr." Upon ascertaining the total

they make out a "second ticket," containing the credit and debit exchanges and the balance, and send the same to the "proof clerk," who transcribes the debit exchange under the head of "Banks Dr." (the credit exchange having been already entered), and the balance on the credit or debit side, as the case may require.

While this is being done the settling clerks are checking back from the small tickets to ascertain whether the amounts agree with the amounts listed on their statements from the exchange slips. By this time the proof clerk has footed the four columns on his sheet, namely, the debit and credit exchanges and the debit and credit balances. If the former two agree with the latter two the work is correct, and the result is announced by the manager, who calls off credits and debits.

As he calls off these balances, which are named in thousands of dollars, the hundreds and fractional parts being omitted, the clerks list the amounts on a special slip provided for the purpose, and thereby secure a general report of the balances of the day to take back with them for the inspection of their several cashiers. By these reports the managers of the several banks are informed of those who have balances to be paid them by the clearing house, and also of those who are to pay amounts into the clearing house.

The time elapsed since the manager sounded his gong for starting the work up to the completion of the proof is perhaps forty-five minutes, or possibly a little more. Three-quarters of an hour is the limit before fines are in order against those who have made the errors that prolong the work, but it is not often that it becomes necessary to impose fines. The record time is thirty-five minutes, although the dates when the proof has been reached in thirty-seven to forty minutes from the time the delivery clerks started on their rounds are numerous. When a particularly good showing in this regard has been accomplished the announcement of the result by the manager is very likely to be greeted with applause.

11-17-98-329		THE FOURTH NATIONAL BANK				190
No. 61.		SETTLING CLERK'S STATEMENT,				
No.	BANKS.	DEBIT	DEBIT	CREDIT		
1	Bank of N. Y. Nat'l B'k'g Ass'n.				1	
2	Manhattan Company,				2	
3	Merchants' National Bank,				3	
4	Mechanics' National Bank,				4	
6	Bank of America,				6	
7	Phoenix National Bank,				7	
8	National City Bank,				8	
12	Chemical National Bank,				12	
13	Merchants' Exchange Nat'l Bank,				13	
14	Gallatin National Bank,				14	
83	Bank of the Metropolis,				83	
84	West Side Bank,				84	
85	Seaboard National Bank,				85	
91	Liberty National Bank,				91	
92	N. Y. Produce Exchange Bank,				92	
96	State Bank,				96	
97	Fourteenth Street Bank,				97	
98	National Copper Bank,				98	
99					99	
100					100	
FOOTINGS,						
BALANCES						

FORM OF SETTLING CLERK'S STATEMENT.

No. 61.		THE FOURTH NATIONAL BANK.		190	
SETTLING CLERK'S RECEIPTS,					
No	BANKS.	DR.	DR.	SIGNATURES.	
1	Bank of N. Y. Nat'l B'k'g Ass'n,			1	
2	Manhattan Company,			2	
3	Merchants' National Bank,			3	
4	Mechanics' National Bank,			4	
6	Bank of America,			6	
7	Phoenix National Bank,			7	
8	National City Bank,			8	
12	Chemical National Bank,			12	
13	Merchants' Exchange Nat'l Bank			13	
14	Gallatin National Bank,			14	
85	Seaboard National Bank,			85	
91	Liberty National Bank,			91	
92	N. Y. Produce Exchange Bank,			92	
96	State Bank,			96	
97	Fourteenth Street Bank,			97	
98	National Copper Bank,			98	
99				99	
100				100	

FORM OF SETTLING CLERK'S RECEIPTS.

New York Clearing-house.	No. 61.	New York Clearing-house,
		1909.
	Debit FOURTH NATIONAL BANK, Am't rec'd, \$	_____
	Credit " " " brought, \$	_____
	\$ _____	Debit Balance Due Clearing-house.
	Cr. bal. due FOURTH NATIONAL BANK, \$	_____
		Settling Clerk.

FORM OF "SECOND" TICKET.

NEW YORK ASSOCIATED BANKS

STATEMENT AT CLOSE OF BUSINESS, OCT. 28, 1922.

ACTUAL CONDITION, CHANGES FOR THE WEEK.

Excess reserve	Inc.	\$27,222,300
Loans	Dec.	51,553,000
Net demand deposits.....	Dec.	92,235,000
Net time deposits.....	Inc.	905,000
Cash in vault Federal Reserve members.....	Dec.	1,427,000
Reserve in Federal Reserve Bank, member banks.....	Inc.	15,529,000
Reserve in own vaults, State banks and trust companies.....	Dec.	228,000
Reserve in other depositories, State banks and trust companies.....	Inc.	17,000
Circulation	Inc.	44,000

ACTUAL CONDITION, ALL MEMBERS.

	1922.	1921.	1920.
Loans	\$4,617,420,000	\$4,369,244,000	\$5,343,273,000
Bills pay., redis., accept. and other liabil.	484,265,000	445,882,000	1,306,823,000
*Demand deposits	3,853,437,000	3,801,070,000	4,137,684,000
Time deposits	434,709,000	224,073,000	274,307,000
Circulation	31,909,000	33,112,000	34,781,000
Cash in vault, Federal Reserve members..	56,607,000	68,534,000	89,745,000
Reserve in Fed. Res. Bank, mem. banks..	540,759,000	501,710,000	544,315,000
Res. in other depos., banks and trust cos.	9,710,000	8,792,000	9,374,000
Cash in vault, State banks and trust cos.	7,559,000	8,908,000	8,966,000

Aggregate reserve	\$367,038,000	\$519,410,000	\$562,655,000
Reserve required	515,851,980	503,035,880	548,859,910

Excess reserve

*Government deposits of \$86,396,000 deducted. Last week such deposits were \$110,802,000.

AVERAGE CONDITION, CHANGES FOR THE WEEK.

Excess reserve	Dec.	\$16,228,520
Loans	Inc.	731,000
Net demand deposits.....	Dec.	43,370,000
Net time deposits.....	Inc.	8,937,000
Cash in vault Federal Reserve members.....	Dec.	769,000
Reserve in Federal Reserve Bank, member banks.....	Dec.	21,685,000
Reserve in own vaults, State banks and trust companies.....	Dec.	179,000
Reserve in other depositories, State banks and trust companies.....	Inc.	369,000
Circulation	Inc.	112,000

AVERAGE CONDITION, ALL MEMBERS.

	1922.	1921.	1920.
Loans	\$4,632,676,000	\$4,380,680,000	\$5,371,577,000
Bill: pay., redis., accept. and other liabil.	404,976,000	438,329,000	1,315,653,000
*Demand deposits	3,892,043,000	3,801,317,000	4,121,880,000
Time deposits	434,905,000	224,472,000	288,189,000
Circulation	31,735,000	33,086,000	34,701,000
Cash in vault, Federal Reserve members..	57,982,000	70,496,000	93,834,000
Reserve in Fed. Res. Bank, mem. banks..	508,471,000	492,382,000	537,562,000
Res. in other depos., banks and trust cos.	9,518,000	8,674,000	9,190,000
Cash in vault, State banks and trust cos.	7,598,000	8,785,000	8,864,000

Aggregate reserve	\$525,587,000	\$509,841,000	\$555,718,000
Reserve required	520,979,710	502,983,910	546,947,650

Excess reserve

*Government deposits of \$95,312,000 deducted. Last week such deposits were \$88,372,000.

CLEARING HOUSE BANK RETURN

AVERAGE FIGURES WEEK ENDED OCT. 28, 1922.

BANKS AND TRUST COMPANIES MEMBERS OF FEDERAL RESERVE BANK.

	Loans, Discount, Investments, &c.	Cash in Vault.	Reserve with Legal Depositories.	Net Demand Deposits.	Time Deposits
Bank of N.Y. & T. Co.	\$72,088,000	\$1,039,000	\$6,714,000	\$49,109,000	\$6,395,000
Bank of Manhat. Co.	125,863,000	2,261,000	13,778,000	99,674,000	19,039,000
Mech. & Metals Nat..	167,034,000	5,335,000	20,269,000	151,064,000	7,002,000
Bank of America.....	67,734,000	1,865,000	8,995,000	66,651,000	2,916,000
National City Bank..	473,679,000	7,327,000	59,667,000	(a) 541,069,000	46,937,000
Chemical National....	123,166,000	1,169,000	14,002,000	101,549,000	12,283,000
Nat. Butch. & Drov..	5,282,000	82,000	563,000	3,684,000	5,000
American Exch. Nat.	101,714,000	1,204,000	10,844,000	79,338,000	9,363,000
Nat. Bank of Com...	331,348,000	953,000	36,448,000	278,246,000	15,227,000
Pacific Bank	22,411,000	1,029,000	3,367,000	22,894,000	798,000
Chat. & Phenix Nat.	151,138,000	6,011,000	16,833,000	122,702,000	23,339,000
Corn Exchange Bank..	110,213,000	457,000	13,490,000	102,656,000	.....
Import. & Trad. Nat.	34,238,000	607,000	21,207,000	154,773,000	23,320,000
National Park Bank..	157,392,000	955,000	16,615,000	126,980,000	25,000
East River National.	14,062,000	369,000	1,637,000	12,018,000	5,001,000
First National Bank..	300,321,000	529,000	24,999,000	184,523,000	1,947,000
Irving Nat. Bank....	196,005,000	4,349,000	26,023,000	195,766,000	34,491,000
Continental Bank....	7,182,000	133,000	951,000	5,849,000	7,000,000
Chase National Bank..	343,012,000	4,352,000	40,224,000	301,479,000	380,000
Fifth Avenue Bank..	22,730,000	616,000	2,881,000	21,634,000	39,520,000
Commonwealth Bank.	8,860,000	437,000	1,136,000	8,853,000	.....
Garfield Nat. Bank..	14,882,000	453,000	1,950,000	13,846,000	66,000
Fifth National Bank.	18,453,000	254,000	2,065,000	15,670,000	764,000
Seaboard Nat. Bank.	77,747,000	1,152,000	9,782,000	73,344,000	1,899,000
Coal & Iron Nat....	15,026,000	679,000	1,544,000	11,957,000	712,000
Bankers Trust Co...	260,079,000	1,028,000	29,308,000	(b) 229,768,000	20,507,000
U. S. Mort. & Trust..	59,192,000	756,000	6,598,000	50,541,000	6,103,000
Guaranty Trust Co...	308,831,000	1,349,000	41,227,000	(c) 394,450,000	32,936,000
Fidelity-Inter. Trust.	19,693,000	365,000	2,332,000	17,939,000	541,000
Columbia Trust Co...	79,098,000	651,000	9,826,000	73,076,000	6,700,000
New York Trust Co...	151,570,000	442,000	16,700,000	125,259,000	14,519,000
Metropolitan Trust...	40,954,000	555,000	4,769,000	35,915,000	3,585,000
Farmers Loan & Tr.	131,969,000	523,000	12,769,000	(d) 89,853,000	30,234,000
Columbia Bank	30,017,000	729,000	3,521,000	27,179,000	2,111,000
Equitable Trust Co...	158,104,000	1,444,000	22,069,000	(e) 191,874,000	8,633,000

Total.....\$4,447,972,000 \$57,982,000 \$508,471,000 *\$3,791,593,000 \$380,298,000

STATE BANKS NOT MEMBERS OF FEDERAL RESERVE BANK.

Greenwich	\$18,852,000	\$1,689,000	\$1,580,000	\$18,706,000	\$56,000
Bowery	5,492,000	325,000	892,000	2,631,000	2,097,000
State	80,917,000	3,328,000	1,785,000	27,071,000	50,602,000
Total.....	\$105,261,000	\$5,342,000	\$3,757,000	\$48,408,000	\$52,755,000

TRUST COMPANIES NOT MEMBERS OF FEDERAL RESERVE BANK.

Title Guar. & Trust..	\$52,793,000	\$1,354,000	\$3,977,000	\$55,392,000	\$1,038,000
Lawyers Title & Tr..	26,650,000	902,000	1,784,000	17,550,000	814,000
Total.....	\$79,443,000	\$2,256,000	\$5,761,000	\$52,942,000	\$1,852,000
Grand total	\$4,632,676,000	\$65,580,000	\$517,989,000	†\$3,892,943,000	\$434,905,000

Include deposits in foreign branches not included in footings: (a) \$98,562,000, (b) \$9,855,000, (c) \$83,152,000, (d) \$93,000, (e) \$25,369,000.

Balances carried in banks in foreign countries as reserve for such deposits: (a) \$22,925,000, (b) \$602,000, (c) \$7,651,000, (d) \$93,000, (e) \$2,908,000.

* Deposits in foreign branches not included.

† United States deposits deducted.

Suggested Readings on Chapter VII.

Cannon, J. G.—Clearing Houses.

Phillips, C. A.—Readings in Money and Banking, Chapter XIX.

Moulton, H. G.—Financial Organization, Chapter XXII.

Questions and Problems on Chapter VII.

I.

The First National brings checks

on the Second National for	\$356,295	\$718,319
on the Empire State for	562,953	183,197
on the American Trust for	629,535	831,971
on the Third National	295,356	319,718

The Second National brings checks

on the Empire State for	\$458,382	\$197,183
on the American Trust for	583,824	971,831
on the Third National for	838,245	861,124
on the First National for	382,458	611,248

The Empire State brings checks

on the American Trust for	\$294,661	\$112,486
on the Third National for	946,612	124,861
on the First National for	466,129	248,611
on the Second National for	661,294	486,112

The American Trust brings checks

on the Third National for	\$953,562	\$775,447
on the First National for	535,629	754,477
on the Second National for	824,583	544,777
on the Empire State for	245,838	447,775

The Third National brings checks

on the First National for	\$612,946	\$945,919
on the Second National for	129,466	459,199
on the Empire State for	337,458	591,994
on the American Trust for	874,730	919,945

a. What is the debit or credit balance of each bank?

b. What percentage do the balances to be paid bear to the total clearings?

2. *A* owes *B* \$1,000. *A* pays *B* with a check drawn on the First National Bank. Trace all the steps in making the payment, assuming that:

(a) *B* banks with the First National.

(b) *B* banks with the Second National, the only other bank in town.

(c) *B* banks with the Tenth National.

3. From a mechanical standpoint, calculate whether it is more efficient to have all of the banks of a city members of a clearing house or have only the large banks members of the clearing house, with the smaller banks clearing through the larger ones.

4. Would it be more efficient to abolish all clearing houses and collect all checks through the Federal reserve banks?

5. In the New York Clearing House returns, what is indicated when the actual figures are higher than the average figures? When the actual figures are lower than the average figures? Why do they publish both the actual and the average figures?

CHAPTER VIII.

CORRESPONDENT RELATIONS BETWEEN BANKS—CHECK COLLECTION.

Banks deal not only with ordinary depositors but with other banks. The banks thus dealing with each other are called correspondents.

Reasons Why Smaller Banks Keep Balances in Bigger Banks.

1. To count as reserves. Formerly, national banks in all but central reserve cities could count bank balances with other approved national banks as part of their reserves. Many State banks can still count their balances with other banks as part of their reserves.
2. To be made the basis for the sale of exchange. The bank can sell drafts, *e.g.* on New York, to its customers.

Services for Correspondents.

1. Dealings in foreign exchange. The smaller banks use their correspondents' facilities to buy and sell foreign exchange and arrange letters of credit for their customers.
2. The purchase of acceptances and commercial paper. If a bank has surplus funds, it may take this method of investing. Its correspondent in the financial center can arrange for the purchase of the type of paper it wishes.
3. Giving credit information. The big banks can afford to maintain elaborate credit departments and furnish information to their correspondents.
4. Collecting checks. The relation in regard to collection may take two forms:
 - a. A large bank in a financial center may be the correspondent of a smaller bank located elsewhere. Each bank collects checks on banks in its vicinity for the other. The smaller bank keeps a balance in the larger bank.

- b.* Two banks of about the same size may be correspondents, each for the other. Each collects checks drawn on banks in its territory for the other. The arrangement is mutual. Sometimes the one bank will hold a balance and at other times the balance will be reversed. This service is now of less importance than before the inauguration of the par-check collection system of the Federal reserve banks. (To be described later.)
- 5. Arranging call loans. New York banks, when requested, make call loans for their correspondents on the Stock Exchange.
- 6. Rediscounting or loaning. For member banks, the Federal reserve banks offer facilities for rediscounting or loaning. Before these banks were available, certain methods were used to get accommodation from another bank without showing the transaction in the statement of the borrowing bank:
 - a.* The bank sold bonds to its correspondent with the right to repurchase them.
 - b.* The directors borrowed on their personal note.
 - c.* The bank sold notes outright to its city correspondent, but agreed to collect them.

Banks not members of the Federal reserve system use their correspondents for rediscounting directly, or use some of these indirect methods of accommodation.

Materials on Chapter VIII.**Typical Journey of a Country Check Remitted for a City Account.**

Adapted from J. G. Cannon, Clearing Houses (1910), pp. 64-74.

The Small Amount of Work Required of Payer and Payee—The
Large Amount of Work Required of the Bank in Which the
Check Is Deposited and Its Correspondent—What the Receiving
Bank Does—What Its Regular Correspondent in the
City Nearest the Country Bank Is Required to Do—
What the Country Bank Has to Do—An
Illustrative Example.

By way of emphasizing the need of the reform that has taken place in the matter of collecting checks, a brief glance at the methods current in various directions at the present time will be advantageous. A merchant in Massillon, Ohio, buys a bill of goods in New York amounting to \$250, and pays for the same with a check on his local bank. The New York jobber from whom the goods were bought makes the proper entries on his books for the check upon its receipt by him, and deposits the check with his (New York) bank. The receiving teller of the bank in which the check is deposited, after checking it off the deposit slip, enters it, by amount only, in his record of out-of-town checks.

Another clerk enters the check on a sheet headed with the depositor's name, stating date of deposit, place of payment, and amount, for the purpose of making the proper charge thereon. The slip is sent to the jobber advising him of the charge. The charge itself is made through a book known as the "Debits of exchange," from which the bookkeeper posts the charge.

A representative of the corresponding department of the bank receipts for the item on the receiving teller's record, after satisfying himself that the amount has been properly listed thereon. Another representative sorts the check with others on a sorting table, according to the place of payment, and then stamps the bank's indorsement on the back of the check.

The check is then laid on the collection inclosure sheet for transmittal to a Cleveland bank, since all Massillon items are collected through that channel by this particular New York bank. The check is next listed by billing machine in duplicate on the remittance letter, which calls for the name of the drawer, place of payment, and amount, together with any instructions that are to accompany the item regarding the handling of the same. The duplicate of this letter, which, in addition to the

information called for by the original, provides a column under which is entered the name of the customer for account of whom the check is received, is retained by the bank as its record of checks sent.

After all these details have been completed, the name of the Cleveland bank is filled in on the indorsement stamp. A record is then made on the letter register, showing the name of the Cleveland bank, date when the collection letter is sent, and the total amount of the items contained in the letter. This record is made in order that the work of the bank may be facilitated in keeping track of its remittances, so that should an acknowledgment of the same not be promptly received, a tracer may be sent out without delay to secure the desired information. Manifestly, it is essential to the bank to know that all letters containing inclosures are promptly and properly acknowledged. An envelope is then addressed, the letter folded and inclosed, the envelope sealed and stamped, and finally examined to see that it is properly addressed, sealed, and stamped. The letter is then mailed at the New York postoffice.

The Cleveland bank, on receipt of this letter, enters in detail upon its books those items contained in it which are payable outside of Cleveland. It then writes a letter to its Massillon correspondent, inclosing the \$250 check for collection, makes a record of the letter and inclosure, addresses an envelope, in which are placed the letter and inclosure, and seals, stamps, and mails the letter.

The Cleveland bank next acknowledges the receipt of the item by drawing and remitting a check on its New York correspondent for the amount, less the usual charge for exchange. It writes a letter inclosing the check, takes a record of the same, addresses an envelope, puts in the inclosures, then seals, stamps, and mails the letter.

The check thus received by the New York bank is checked off the remittance letter, is stamped with the paid stamp of the collecting bank, is listed upon a slip with the other items received by the bank the same day upon the other New York bank on which the check received by it is drawn. The items thus made up are collected through the clearing house. The paying bank checks off the items paid through the clearing house from the slip on which they are listed, examines the check in question to see that it is properly drawn, dated, and signed, and that the signature is genuine, charges the check to the Cleveland bank's account on its books, cancels it, enters it on a voucher list, and at the end of a given period returns the check with others to the Cleveland bank.

The Cleveland bank, upon receiving its account current, voucher list, and canceled vouchers, immediately checks off the vouchers and verifies the statement of account. It then compares the checks with the stubs

in the check book, and examines the checks themselves to ascertain if the indorsements are correct or if any alterations have been made thereon, and at last files the checks away for future reference, including the one that has been used in the particular case under consideration.

The letter from the Cleveland bank to Massillon containing the item is mailed the same day that the check is received from New York. It is received in Massillon the day following. After carefully examining the check to see that it is properly drawn and dated and that the signature is genuine, the Massillon bank charges the check to its customer's account and then draws its check on Cleveland, less the usual charge for exchange in payment of the same. It next writes a letter, inclosing the check, takes a record of the same, addresses an envelope, puts in the inclosures, and then seals, stamps, and mails the letter.

The customer in due course has his account made up, checks off the canceled checks returned by the bank from the voucher list, compares the checks with the stubs in his check book, examines the checks to ascertain if the indorsements are correct or if any alterations have been made, and finally files them away for future reference.

The Cleveland bank, upon the receipt of the remittance from its Massillon correspondent, completes its records by filling in the date of the receipt of the remittance and the amount of exchange charged by the Massillon bank.

The check thus received is listed by the Cleveland bank upon a slip containing all the items received by it the same day upon the other Cleveland bank on which the check is drawn. The items thus made up are then collected through the clearing house. The paying bank checks off the items paid through the clearing house from the slip on which they are listed, examines the check in question to see that it is properly drawn, dated, and signed, and that the signature is genuine, charges the check to the Massillon bank's account on its books, cancels the check, enters it on the voucher list, and at the end of a given period returns the check to its correspondent, the Massillon bank.

The Massillon bank, upon receiving its account current, voucher list, and canceled checks from the Cleveland bank, immediately verifies the statement of account, compares the checks with the stubs in the check book, and examines the checks themselves to ascertain if the indorsements are correct or if any alterations have been made in them, and, finally, files the checks away for future reference.

In order to effect the collection of the aforementioned check, drawn on a country bank and remitted to New York in payment of an account, two checks had to be drawn, four letters had to be written, 8 cents in postage stamps were used, and seventy-five or more handlings of the

check were involved by a score or so of clerks, in five different banks, located in three different cities.

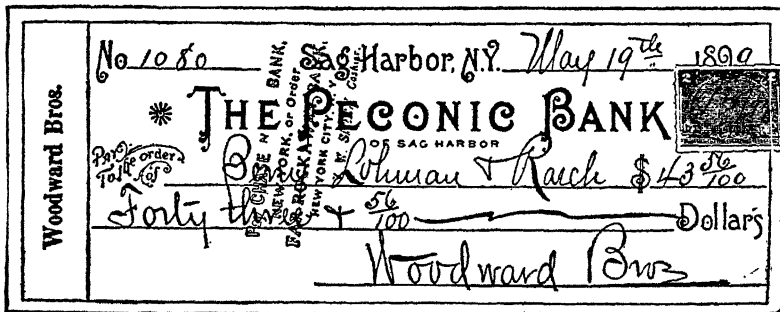
Lest the picture should seem to be overdrawn—for, in fact, that which has been presented is only an average case—the following account of the actual travels of a check, of much smaller size and drawn upon a bank much nearer New York than Massillon, is submitted. It is illustrated by a reduced fac-simile of the check itself and the indorsements that it received in transit.

The check, which was for \$43.56, was drawn by Woodward Brothers, of Sag Harbor, N. Y., and paid to Berry, Lohman & Rasch, of Hoboken, N. J., who deposited it in the Second National Bank of Hoboken. This bank sent it to Harvey Fisk & Sons, of New York, who, having no regular correspondent in the neighborhood of the bank on which it was drawn, sent it, along with other collections, to their Boston correspondent, the Globe National Bank. The Globe National Bank of Boston, for reasons that are not apparent, sent it, presumably with other items, to its correspondent at Tonawanda, N. Y., viz, the First National Bank of that city. The Tonawanda bank, evidently realizing that the check had wandered far out of its course, and in an effort to get it nearer home, transmitted it to the National Exchange Bank of Albany, which institution, pursuing the same commendable policy, remitted it to its correspondent at Port Jefferson. The First National Bank of Port Jefferson, which thus got possession of the check, again diverted its course by inclosing it to the Far Rockaway Bank. The Far Rockaway Bank sent it back to New York, to the Chase National Bank, and thus this much-traveled check made its second call in the metropolis. The Chase National Bank, it would appear, endeavored to correct the wanderer's course, and so dispatched it to Riverhead, to H. M. Reeve. Mr. Reeve, either because he really knew where to send it for collection, or because of a lucky hit, forwarded it to the Queens County Bank of Brooklyn, which finally sent it home to the Peconic Bank of Sag Harbor, on which it was drawn.

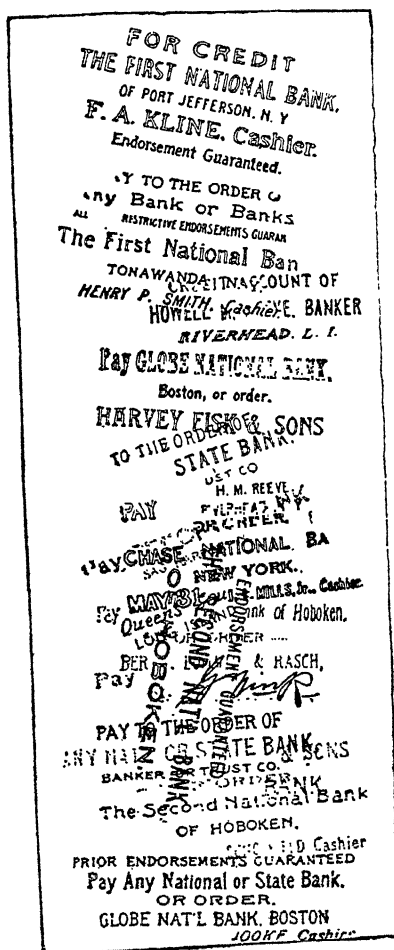
The reason why banks forward checks in this apparently unreasonable way, often getting the items far out of their regular course, is easy to explain. It sometimes appears cheaper to the bank which has the check in hand to inclose it with other items to some regular correspondent, which, assumedly, is nearer the bank on which the check is drawn, than to hunt up a special correspondent for it alone. Once started, the poor check gets pushed along from station to station, on its erratic course, until such time as, by accident or otherwise, it finds its final lodgment.

The reader may estimate for himself the volume of correspondence

which this one check caused, from the time it was drawn by Woodward Brothers until it was paid by the Peconic Bank, and the amount of postage and cost of clerical work expended upon it. No better argument than the facts here presented is needed to support the proposition of charging a reasonable sum for collecting out-of-town checks. No better illustration than this could be presented to the business man for demonstrating to him the weight of the burden he puts on the banking machinery of the community by remitting his check on a country bank, in payment of an account, instead of purchasing exchange.



FAC-SIMILE OF THE CHECK, THE JOURNEY OF WHICH IS SHOWN ON THE MAP FOLLOWING.



FAC-SIMILE OF THE BACK OF THE
CHECK, SHOWING THE NUMEROUS
ENDORSEMENTS IT BORE ON FINALLY
REACHING THE BANK ON WHICH IT
WAS DRAWN.

Methods Followed by City Banks in Granting Accommodation to Correspondents.

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Herewith is presented a first installment of the results of a study made by the Division of Analysis and Research of the Federal Reserve Board of the methods pursued by city banks in granting accommodation to their correspondents. The particular object of this inquiry is to ascertain the extent to which relatively standardized methods are in vogue and how the practice of banks has developed since the adoption of the Federal Reserve System.

The following installment of this study presents the results of inquiries made with the assistance of leading New York City institutions. Similar inquiries into the situation in the South and West are now in progress, and the further results of the investigation will be published in a later issue.

The methods which are followed in the extension of accommodation to banks differ in important particulars from those followed in extending accommodation to mercantile houses. With the latter, borrowing is assumed to be only a natural and recurring operation. The general operations of the enterprise are considered, and on this basis the line of credit is extended. Borrowing by a bank, however, is in general not so regarded. Instead of viewing its transactions as a whole and on this basis determining the line of accommodation, it is desired rather to go back of the general operations and to consider the specific transactions which occur, to the extent at least of having the paper representing this transaction as collateral, and analyzing these bills receivable to some extent. In consequence no line of credit is in general fixed, but each individual case is considered on its merits, specific amounts being granted as needed. The line of credit then is employed only in a somewhat restricted sense. The position which is assumed with respect to bank borrowing is well stated by one institution in the following words: "We avoid as far as possible suggesting lines or limits as to the extent we would serve the borrower, simply indicating our disposition fully to meet their reasonable requirements in liberal proportion to balances maintained and with due regard to amount of their capital investment and borrowings elsewhere, but quite frequently the borrowers suggest lines themselves which we agree to if circumstances warrant, conditioned on everything continuing satisfactorily." One institution, however, regularly fixes lines for its bank borrowers as well as for its mercantile accounts, while another quite frequently fixes lines in the case of banks,

especially southern, western, and southwestern banks which are regularly in need of funds each year.

The amount which is loaned is also often limited by law. In the case of national banks, section 5202 of the Revised Statutes limits the indebtedness for loans or rediscounts, other than with the Federal Reserve Bank, to the amount of unimpaired capital, and in many States there are provisions covering this matter. A leading institution states that when a State bank appears to be borrowing or rediscounting to an amount in excess of its capital and surplus it is generally made the subject of special consideration and inquiry. Another institution also states that it endeavors to limit accommodation to the capital investment, while in the case of a third bank the accommodation granted is always less than the capital. With another bank, the line granted is limited to the capital, but due regard is given a large surplus and profits item. The amount of accommodation, of course, varies with the type of paper offered, and would not be on the same basis for an institution offering paper ineligible for rediscount as for one offering eligible paper. Several institutions state that with respect to rediscounts with the Federal Reserve Bank, they go on the presumption that the paper rediscounted is probably of such good quality that the contingent liability of the bank indorsing the same is negligible, and hence disregard this item when considering the accommodation to be extended.

I. Sources of Information.

Contents of the file.—Credit files in general are classified into certain sections, corresponding to the source of data, although one of the institutions from which data were obtained, which has a relatively small number of borrowing accounts, and which relies largely upon personal knowledge of and acquaintance with these institutions, files chronologically all its material on the subject bank, consisting of statements and correspondence. The data in general will include: (1) Statements of the institution, (2) abstract of direct correspondence with it and carbons of replies to it, (3) correspondence with other institutions, (4) agency reports where these are obtained, and (5) reports of representatives, in some banks only where giving special information, in other banks the latest reports, previous reports being placed in the new business file in both these cases. Newspaper clippings are also kept in some cases, and memoranda drawn up on the bank will be included. Certain institutions also keep the overdraft record, listing separately each item and showing whether it occurred against uncollected items or the balance record, showing average daily balances and borrowings in this file.

Unfavorable data may be specially marked, or listed on a specially colored sheet. The arrangement of the individual file of course differs and the degree of completeness varies considerably. The complexity will naturally depend in part upon the number of accounts, also upon the extent to which the individual officers in charge prefer to rely upon their personal knowledge, or desire a more or less elaborate system of recording data to supplement these impressions.

Experience of other institutions.—The most helpful data for guidance from outside sources, states a leading New York institution, "are obtained by writing to all other correspondents of the subject bank." This institution prepares its list from the various issues of the Bankers' Directories, as well as observing from what banks transfers come for credit to the subject's account. In addition communication may be had with the correspondents of the inquirer which are located in the neighborhood of the subject. Thus communication may be had with another bank in the same town or banks in near-by towns. As it is a matter of some delicacy to make inquiry of a bank located in the same town as the subject, in view of the competitive prejudices which might exist locally, and in order not to divulge the source of such inquiries, communication in such cases is usually had with some city correspondent of the inquirer who has a correspondent in the town in question. It is generally considered that to New York City banks data from other banks in the borrower's general locality are a great help, as such banks are close to the subject and to the people back of it, supplying the personal element which may be lacking in New York as compared with the lesser banking centers. In addition, if the subject bank maintains any other account or accounts in New York City, inquiry is made by personal visit of a representative of the credit department who exchanges views and data. One institution, where it has a personal acquaintance with a leading merchant in the vicinity of the subject, also obtains his opinion.

In these letters of inquiry information is usually requested as to (1) the antecedents of the dominant factors (especially in the case of a comparatively new institution) and the general standing of the subject bank in the community, prospects, etc., (2) the character, ability, and conservatism of its management, as well as in some cases the financial responsibility of its officers and directors, and (3) the relations had with the subject bank, one institution stating that it requests information as to the extent to which the bank borrows, the method of borrowing, and the continuity with which it borrows. A voluntary expression of the inquirers' opinion may be given, together with information on the subject's transactions with the inquirer. Occasionally inquiry may be made as to the subject's performance in the matter of balances. The com-

plaint has been made by some bankers that letters from banks in the majority of cases are very general, the opinions on the first two points being merely in general terms, and the statement, for example, added that "we consider them good for any reasonable amount." One institution, in fact, regards the experience of other New York City institutions as distinctly more helpful than that of out-of-town banks.

Communication is in general had with the same banks from year to year on a given subject, although some institutions vary the list somewhat, and thus the statement may be received that "we have found nothing to change the opinions expressed in our letter of —," naming a date several years previous. In case additional connections have been established, communication will be had with them, or, in case an account is closed, inquiry will be made of the correspondent with whom the account of the subject has been closed as to the reasons therefor.

A New York City institution which has a relatively small number of accounts and whose correspondents have been with them for years writes only in case of poor behavior, such as slowness in payments or offering of paper close to directors, and then generally communicates with banks in the neighborhood of the borrower, or a New York bank if the subject is borrowing in New York. In this case inquiry is made only on some specific point, such as whether the institution is loaning the subject.

One institution, in addition to exchanging experiences with other institutions which inquire of it concerning the subject bank, also has a somewhat different procedure for obtaining data as to State bank borrowers, upon which it places especial value. Up to several years ago an officer of this institution made it a regular practice to attend bankers' conventions in the Southern States, at which he obtained data as to the bank and made commitments as to the line to be extended. These data were as follows:

(1) From representatives of the bank, information as to character of business, giving kind of collateral available, names and approximate net worth and character of directors, and names of correspondents at other points.

(2) From other correspondents, comparison of notes as to lines, rates, collateral, margin, etc.

(3) From State superintendent and State bank examiner, obtaining expression of their opinion as to the moral risk, efficiency of management, etc.

The second and third sources afford a ready check upon the information obtained from the bank itself.

Frequency of revision of the file.—Annual revision of the files is

the general practice, although more frequent inquiry may be made on some borrowers, and especially respecting status of institutions located in sections subject to radical changes, such as drought, flood, etc. One institution states that it has been prevented from making its regular revisions in all cases during the war period owing to pressure of other work. Another institution revises its files every six months, unless banks borrow only once a year, when annual revision is made. A leading institution states that it endeavors to make the annual revision during the early months of the year, with a view to obtaining information in respect to total borrowings of the subject bank during the past season and promptness in clearing up, or otherwise, and revises files of non-borrowing institutions less frequently. The institution mentioned above as having a relatively small number of accounts makes no periodic revision of its files.

Statements of the subject bank.—These are regularly received, the bank in general being educated to send them regularly. In general the condensed form as published is regarded as sufficient. Abstracts are made in the credit department to a comparative statement form in five of the institutions, one of the others is developing such a form and two have no such form, one of the last being a leading institution for this class of business. One of these, however, keeps an annual record of capital, surplus and profits, and deposits on the card showing monthly balances and loans, both direct and indirect. The comparative statement form in certain cases is arranged horizontally, in others vertically. The number of items differs, as well as their order, and certain institutions include different items. In view of this diversity, the clearest method of presentation of current practice will be to reproduce the items for certain institutions. It will be observed that in the fifth case attempt has specifically been made to devise a form which would be suited to foreign as well as to domestic practice.

An institution which has a large number of accounts states that statements received from nonborrowing accounts are simply kept on file and not transferred to the comparison form.

Representatives' visits and agency reports.—At regular intervals the majority of correspondents are visited by district and traveling representatives, who also attend conventions of various State bankers' associations. Representatives, however, in general are primarily attached to the new business department, and report only such information as they happen to hear from time to time. In certain cases they also make special inquiries as directed. Valuable information as to the management of the bank and the men behind it is obtained in this way, states one banker. Representatives attending these conventions are not author-

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Cash on hand and in banks. Loans and bills purchased. Overdrafts. Investments. United States bonds. United States bonds to secure circulation. Stock of Federal Reserve Bank. Redemption fund; United States Treasurer. Reserve with Federal Reserve Bank. Banking house. Furniture and fixtures. Other real estate. Customers liability on acceptances. Accrued interest. Other resources.	Loans and discounts. Commercial paper securing circulation. Unsecured overdrafts. Stock in Federal Reserve Bank. United States bonds to secure circulation. United States bonds to secure postal savings. Securities securing circulation. Securities unpledged. Real estate and buildings. Cash and due from banks.	Loans and discounts. Overdrafts. Securities. Real estate.	Capital. Surplus and profits. Deposits. Borrowed money. Circulation.	Cash and on call. Investments. Loans and advances. Bills discounted. Acceptances. Branches, correspondents. Bank promises. Sundry and contra items.
Total resources.	Total resources.	Total resources.	Total liabilities.	Total.
Capital stock. Surplus. Undivided profits. Reserves. Acceptances. Discounts. Bills payable. Deposits. United States deposits. Banks and bankers. Miscellaneous.	Bills payable. Bills discounted. Circulation. Demand deposits. Time deposits. Postal savings. Total deposits. Surplus and profits. Capital stock.	Capital. Surplus and undivided profits. Bills payable and rediscouts. Deposits.	Cash assets. Loans. Stocks and bonds. Banking house, furniture and fixtures. Other real estate.	Capital. Surplus reserves. Profit balance. Deposits, current accounts. Acceptances, drafts. Branches, correspondents. Expense reserve. Sundry and contra items.
Total liabilities.	Total liabilities.	Total liabilities.	Total resources.	Total.

ized to make commitments; but in case officers attend, such commitments are frequently made. One institution, however, states that it has no staff of representatives.

Agency reports are frequently kept. One bank obtains them when the account is opened and, in the case of accounts which borrow, obtains them later at reasonably frequent intervals, while another obtains at least one at each revision of the files. The principal value of these reports, it is generally held, is to show the net worth of officers and directors of the subject bank and their possible business affiliations. They thus afford certain "leads" indicating where further information may be obtained. Occasionally reports of the officers' and directors' firms may be obtained, but this is not the general practice. Some banks do not keep agency reports.

II. Relation of Amount of Accommodation to Balance Maintained— "Clean-up" Requirements.

Balances.—While certain institutions have no formal rule as to the relation which the balance maintained shall bear to the line of accommodation, other institutions fix a certain percentage, which is generally adhered to, although exceptions are made at times. This is usually fixed at 20 per cent, or in some cases at 25 per cent, of the accommodation extended, several institutions reporting that they calculate the annual average balance in applying the test. In several cases a minimum dollar amount is also fixed for the balance, instances of \$2,500 and \$3,000 being reported, and the minimum capital and surplus of the borrowing banks in the former case is fixed at \$25,000. Two banks report exceptions to the nominal 20 per cent rule (for balances at any one time) for a first-rate correspondent which is not a frequent or chronic borrower, while another has no bank whose balance goes down to 20 per cent. The balance may be stressed particularly in case of renewals, or application for a larger line than appears warranted, the matter in such cases being brought to the correspondent's attention.

A few correspondents are reported by some banks who are believed to be perfectly good, but do not keep more than, say, a 10 per cent balance, and in such cases the meager balances may be offset by higher discount rates, or the elimination of interest on balance when borrowing. One bank states that such cases are confined to banks in large cities, but that there is no sectional difference apparent, the policy being dependent rather upon liberality of management. Two other banks, however, state that the smaller balances occur rather in the case of the smaller banks.

Balances, in addition to their relation to the profitableness of the

account, may afford also an indication of the character of the management. Thus small balances taken in conjunction with frequent overdrafts may mean that a bank is working too closely on its resources. Overdrafts, however, frequently are permitted only against uncollected items. The balances maintained are frequently an indication of an easy position or otherwise. Occasionally a country bank improperly endeavors to maintain two or more New York accounts with the hope of procuring through each a larger line of accommodation than balances would warrant, and this necessitates watching closely the balance and borrowing in New York where other accounts are maintained in New York.

Character of borrowing.—Borrowing in general is of two classes: (1) For seasonal needs, and (2) for extraordinary needs and special purposes. Certain New York institutions insist that the borrower be cleaned up for a reasonable part of each year, and a more frequent clean-up is encouraged. Admonition, direct suggestion, and request are employed; occasionally advance in rates. The seasonal clean-up depends, of course, upon the nature of the crops and the section of the country, as well as upon special conditions, such as the transportation situation which may arise and which may render renewals necessary. It is generally agreed that the South during the last few years, in place of its former needs which led to borrowing, has had a surplus instead, and is now loaning elsewhere to some extent. Florida banks frequently borrow during the citrus-fruit season in the late autumn and during the winter. Loans to banks in the cotton States are frequently made, not only in the spring to aid in making the crop, but also during the autumn and winter, in case customers are holding cotton, and this is especially true of banks located at concentration points. Similarly, banks in the grain States as well as elsewhere make application not only for the preparation of crops but also for moving them after harvest. Maturities on loans for crop-moving purposes are in general the periods at which funds from the crops ordinarily will come in. One leading New York institution states that in the case of loans made unusually early in the year, such as January, February, and March, and when it judges that the borrower will be unlikely to retire the loan until the autumn, it occasionally asks for a note for, say, four months, with the privilege of renewal until autumn, if everything continues satisfactory. Short renewals are rarely objected to where apparently reasonable by virtue of crop conditions.

Special needs of a temporary character may be represented by unexpected or large withdrawals of deposits, or in the past in connection with Government finance. Banks in out-of-town cities usually require

funds for shorter periods than banks employing them in connection with crops, while city banks, of course, frequently borrow simply because of some unexpected temporary change of position. While the banks from which data were obtained in general loan for both needs, and some institutions more largely for seasonal purposes, one institution loans more largely for emergencies than for seasonal needs, its borrowing accounts making other arrangements with respect to their seasonal requirements.

Continuous borrowing is permitted by one institution in a very small number of cases for banks located in large cities which lack sufficient banking capital to meet the continuous borrowing demands, and in such cases sufficiently well rated paper at profitable rates is given. Another institution states that it has not insisted upon a clean-up from banks borrowing on Government bonds.

III. Forms of Accommodation.

Accommodation may be obtained in a variety of forms. Paper may be rediscounted, or a loan be made, which may be either unsecured, or have as collateral bills receivable or securities. Loans may be made on demand, or for a fixed maturity. Among special forms is borrowing by means of a certificate of deposit, or by sale of securities with a repurchase agreement.

Security of the loan.—The larger proportion of accommodation extended by New York institutions is in the form of loans rather than rediscounts. There are practically no unsecured loans. A leading institution advises that in some of the extremely few cases where accommodation is extended to banks without security, the note is indorsed individually by a strong board of directors. Collateral is desired for the assurance of safety which it gives. Certain institutions prefer bills receivable as collateral; others, however, prefer securities. In recent years, of course, considerable loans have been made against Liberty bonds, but two banks report a lessened use of them for some time. The proportions of the loans of the individual institution which consist of either class of collateral, of course, vary from time to time, and differ from bank to bank according to the general character of business of the lender, but the loans of certain institutions are largely against securities, while for other institutions the large majority consist rather of bills receivable, loans against stocks and bonds, other than Liberty bonds, being correspondingly small in amount. One institution reports a difference between loans for fixed periods and demand loans, securities providing 10 per cent and 50 per cent, respectively, of the collateral.

One banker states that as a result of the small bond purchases by banks due in part to the decline in bond values, the amount of the same employed as collateral in negotiating loans is likewise small. Some institutions report loans against securities as being made largely against those purchased through the institution and held in New York on special deposit, while for others, however, the reverse is true.

The margins against the various classes of securities differ. Thus three institutions report that on Government bonds they require a 5 per cent margin, noted by one institution as being figured on current market values, although it loans at par in a few instances, notwithstanding that present market values are lower. Three institutions, however, require a 10 per cent margin on such collateral, and one of these requires no margin on certificates of indebtedness. Customary margins on other types of security are in general the same as on bills receivable, namely, 20 or 25 per cent, although one institution requires only 15-20 per cent, with 10 per cent on municipal bonds (noted also by another institution), while another usually requires only 10 per cent. Several institutions accept also a lesser amount of collateral offered in the form of prime active listed securities by good borrowers, although whenever they are in position to express any preference they ordinarily suggest that the full margins be given. The question of margins is of course subject to the limitation of the State law existing in the case of State banks, restrictions existing in some States.

Use of bills receivable.—A bank may borrow on its bills receivable in one of two ways, either by rediscounting or by employing them as collateral for a loan. A leading New York City institution states that it is practically the universal custom throughout the country, outside of transactions with Federal Reserve Banks, for borrowing banks to give their own note with collateral and margins, unless they are in a position to offer well-rated commercial paper, in which event they frequently expect that offerings of the latter character, including livestock paper providing its own margin, will be handled in the form of rediscounts. Another leading institution states, however, that "since the advent of the Federal Reserve Banks an increasingly large number of correspondent banks are arranging their borrowings in that way," whereas "formerly almost all loans were in form of bills payable with a margin of collateral," but practically all the other institutions report no appreciable change in the form of obtaining accommodation during this period. A number of the larger institutions have always rediscounted only occasionally, in reasonable amounts, for instance, for borrowers of highest standing, and prefer collateral loans. It may be noted that, aside from the security afforded, there is an advantage in

the case of the collateral loan as against the rediscount, in the event of failure of the borrower. With the former the lender has the legal right to offset the balance which the borrower has with it, while in the case of the rediscount a special agreement is required. Rediscounts may be employed to care for "excess" loans which the borrower itself cannot handle, in which case arrangements may be made for the lender to at once rediscount the paper, without recourse on the part of the borrowing bank, in many cases with separate guaranty from officers or directors of the bank.¹

Certain institutions apparently believe that the principal accommodation on the basis of bills receivable should be obtained from the Federal Reserve Banks. One institution states that what it terms "hodgepodge" paper is put up with it as collateral at times to obtain additional accommodation after having gone to the Federal Reserve Banks with other paper, although it rediscounts eligible paper for correspondents; while another states that it often happens that member banks in cities rediscount their eligible paper at the Federal Reserve Bank, leaving the less eligible receivables to be handled by their New York correspondent. One institution which does a considerable portion of stock exchange financing as distinct from pure commercial banking, and which rediscounts infrequently for correspondents, scrutinizes very carefully requests for accommodation by member banks against bills receivable, while another institution, similarly situated, in general makes no such loans to member banks of the Federal Reserve System, and would require an explanation were such an application made.

While the customary margins against bills receivable in the majority of cases are 20 to 25 per cent, there is considerable variation shown. In the case of certain institutions, against miscellaneous receivables it may be as high as 100 per cent, and in case there is a little question as to the standing of the borrowing bank, in addition to the borrowing bank the indorsements of directors may be demanded. In several institutions the upper limit is given as roughly 50 per cent. In other cases the margin at times may be considerably less. Several institutions require no margins for some first-rate correspondents, or 5 per cent, 10 per cent, or 20 per cent in other cases. One institution gives the usual margin as 10 per cent, running up to 25 per cent in certain cases, while another places these two figures as its usual limits. Another institution states that frequently borrowers send in collateral which only gives a 10 per cent margin, which, if everything else is satisfactory, is accepted, but in many cases attention is called to the 20-25 per cent margin rule. A

¹ Another method of handling such loans stated by one banker is by loan upon the direct obligation of the officers of the bank secured by the bills receivable indorsed without recourse by the bank mentioned below.

leading institution states that "occasionally when a borrowing bank gives us as collateral well-known commercial paper names that we would be willing, if desired, to handle on a rediscount basis, we are not exacting about the matter of margin, taking without complaint whatever amount of such collateral may be offered even though it provides no margin, or only a small margin."

Maturity of loans.—Practice differs somewhat with respect to the maturity of loans. Some institutions largely have demand loans, while others strongly prefer loans for fixed periods. The former in some cases, although this is not universally true, are institutions having a large proportion of their loans against securities as collateral, but one of these has made loans for fixed periods (up to 90 days) where Liberty bonds are the collateral, in order to render them eligible at the Federal Reserve Banks. Demand loans are generally of shorter maturities, and certain institutions state that with rare exceptions they do not run beyond 90 days, while for another institution they average one to two months. It is generally desired to have these loans upon a call basis, and if they appear to be a fixture, to endeavor to put them upon a fixed maturity basis instead. One institution instances the convenience of demand loans, but other institutions permit anticipatory payment and refund the interest for the unexpired period. A favorite maturity is 60 to 90 days, and the upper limit in most cases is six months, except in the case of a leading institution for small southern institutions, while another bank, however, reports its loans as running 30–60–90 days. The adaptation of the maturity of crop loans to the period when crops come in was noted above. Another leading institution endeavors to have small banks give notes of fixed maturity, while large banks in important cities frequently borrow temporarily on demand for temporary use. On loans of fixed maturity this institution ordinarily deducts interest in advance, whereas on demand loans the interest is collected at the end of each month.

Holding of collateral.—While the collateral is generally held by the lending institution, in infrequent cases arrangements may be made for holding, under trust receipt, by another institution, in general in the locality of the borrower. This occurs more frequently in the case of banks located at a considerable distance, such as on the Pacific coast, in order to avoid the expense, inconvenience, and risk attendant upon shipment of the collateral. Another reason given is to effect substitution. One institution in an extremely few cases returns the collateral, after listing it, upon trust receipt of the borrower or of a properly constituted custodian. It is stated that "through long-established custom some banks, particularly in Georgia and some of the other cotton States,

request the return of their collateral along about the first of each September, in order to facilitate their making prompt collections," and that in cases where entire confidence is felt in the management of such banks, their wishes are usually met, a trust receipt being taken, but no renewal is permitted without requiring explanation and fresh trust receipts, as well as usually fresh collateral. Another institution permits holding by other institutions where the loan is to run for a few days only, requiring otherwise that the collateral be forwarded to New York. One bank states that it holds the collateral itself until a few days before its maturity, although another bank forwards each month the maturities of the following month for collection or substitution. Substitution in general is permitted without requiring reduction of the loan, or inquiry whether the receivables returned on account of approaching maturity have been paid. One institution states that with its loans, substitutions rarely occur, as in practically all cases the receivables given as collateral bear a later maturity.

Special forms of accommodation.—Borrowing against certificates of deposit is but rarely requested by borrowers. Some institutions report that they at times grant accommodation in this form. Bills receivable are required as collateral in such cases by one institution. Borrowing in this form is reported to be frequent among banks on the Pacific coast and in the Northwest. The use of this and similar methods of borrowing is due to the prejudice previously existing in some localities against banks showing bills payable or rediscounts in their published statements, which is disappearing. There is, however, still stated to be some tendency for banks in Minnesota and the Dakotas, and to a small extent in Kansas, Iowa, and Texas, toward borrowing in forms that would not appear in reports of condition, such as against certificates of deposit or personal notes of officers. One bank states that "since about 1914 marked progress has been made in the direction of banks borrowing in proper form instead of irregular methods."

In rare cases some of the officers of a bank may be sufficiently strong financially to give their personal note, which would represent larger net worth than a secured note of the bank, or in a few instances notes signed by officers or directors of the bank may be given, collateralized by a like amount of bills receivable which they personally purchased from the bank under proper bill of sale. In line with the quotation given above, another institution notes that directors' indorsements are less frequent now than formerly, being employed for paper indorsed by the borrower without recourse, or in the case of renewals by small institutions under unfavorable conditions, such as, for example, in the case of Georgia banks in 1914. Another institution, in addition to requiring

the usual collateral, may occasionally require directors' indorsements where there is a little question as to the standing of the borrowing bank. Other institutions, however, state that they would refuse accommodation if such a procedure were felt necessary.

There is also to some extent purchase of securities or bills receivable under repurchase agreement. Such transactions are almost entirely without margin. One institution reports occasional purchase of prime listed active securities at current market value, usually from institutions in large cities, under agreement to repurchase at the same price on demand or within a reasonably short period. This may be done at times for special purposes, such as in connection with taxation.

IV. Parts of the Analysis.

Analysis of bills receivable offered as collateral.—The preference is expressed by several institutions for small well-assorted notes of strictly seasonal or active character rather than notes of relatively large denominations and notes of makers who would be likely to require renewals. A presumption in favor of the legitimacy of the paper, observes one banker, is established by the recurrence of the same names each year at the same season of the year, as well as by nonsubstitution of the same names. The offerings are listed to show the proportion consisting of rated names, and also, in the case of a leading institution, "whether any paper of the same names is already held." The dates and maturity of the receivables will also be examined to show whether any are of "ancient or long-time character"; and denominations will be considered, as well as whether any of the notes run in the direction of officers or directors of the borrower. While statements of makers in certain cases are reported as rarely received, a form is in general attached in the case of paper of agricultural makers to be filled out by the borrowing bank, showing the maker's character and general standing in his community, net worth, etc. One bank states that it tries to educate banks to send statements in advance, but that where this is not done the correspondent is wired to send statements, and the loan may then be made prior to receipt of the statements. Paper may be taken subject to check, and may be rejected on the basis of the statement. In occasional cases, where it appears desirable, the receivables may also be investigated. One institution states that the extent of the analysis made by it depends entirely upon the strength of the borrowing bank, little investigation being made where the bank is strong.

Varying opinions were expressed as to the eligibility of the bills receivable given as collateral for rediscount with the Federal Reserve Banks, certain institutions believing that the majority were eligible, while

others held a contrary view. One institution states that in the case of country banks the paper is frequently ineligible, due to maturity or otherwise, but that the rated paper received occasionally from city banks who borrow on demand or rediscount would be eligible. The matter, of course, depends in large part upon the extent to which borrowing institutions employ the Federal Reserve Bank when borrowing on receivables, which was mentioned above.

Consideration of data regarding the bank—the statement of condition.—Analysis of the statement in general involves consideration of the absolute size of various items as compared with other items. In no case were ratios formally calculated, extra large items merely being considered. One bank places little reliance upon statement analysis, as it holds that “a good statement may be rotten at the core.” The items to which attention is paid, and the “subjective” ratios, as they may be termed, which are considered, are of course fairly standardized. Among these will be the ratio of deposits to capital investment, as indicating whether deposits are sufficiently large to do a profitable business; and the growth of the institution, as evidenced in particular by growth of deposits and surplus and undivided profits, or dividend record, giving attention to opportunities arising to ascertain whether the bank is properly and promptly charging off slow assets or depreciations. On the other hand, attention must be paid to see that the volume of business done is not too great, and here, as a test of “overloaning,” the ratio of loans to deposits may be considered, as well as the ratio of deposits to capital investment. The second group of items deals with the character of assets, in particular the proportion of fixed assets, such as bank building, real estate, furniture and fixtures, or such items as “other real estate,” as related to the capital investment; and assets of a possibly slow character, such as stocks and bonds (other than Government securities), as well as the reserve maintained. Third, the borrowing of the institution will also be observed, and frequently information will be possessed as to the total lines granted by other correspondents, in order to consider the amount of total borrowings. The lines expected from New York correspondents are usually larger than the amounts borrowed from correspondents of lesser loaning ability. The overdrafts shown may, of course, be significant.

Handling of the account by the borrower.—This is naturally regarded as affording one of the most valuable indications of the character of management and business methods of the borrowing institution. Certain matters are generally pointed to in this connection. The general significance of balances was indicated above. A balance which continually fluctuates in an erratic manner might also indicate poor

management. The significance of the overdraft record was likewise indicated above. One institution states that when the account becomes unsatisfactory by reason of overdrafts it makes inquiry in the town and immediate vicinity where the bank is located to ascertain the general local situation, as well as any special reasons which exist for the condition of the account. "The matter of prompt reconciliation of monthly statements of accounts is also carefully watched," states a leading institution, "as lack of diligence in these respects is frequently significant," and likewise with the promptness or otherwise with which a bank makes substitutions for maturing receivables.

Suggested Readings on Chapter VIII.

Langston, L. H.—Practical Bank Operation, Chapter V-VIII.

Scott, W. A.—Money and Banking, pages 117-121.

Phillips, C. A.—Bank Credit, Chapter XV.

Questions and Problems on Chapter VIII.

1. Two banks, *A* and *B*, write in to their correspondents asking that they be granted rediscounts. The bank can accommodate only one of them. On the basis of the following statements, which should be granted the accommodation?

<i>Resources.</i>	<i>Bank A.</i>	<i>Bank B.</i>
Unsecured Loans (average 2 months)	\$200,000	\$400,000
Real Estate Loans	200,000	
Real Estate	25,000	25,000
Bonds	50,000	25,000
Cash	25,000	50,000
	<hr/>	<hr/>
	\$500,000	\$500,000
 <i>Liabilities.</i>		
Capital	\$50,000	\$30,000
Surplus	75,000	15,000
Undivided Profits	25,000	5,000
Deposits	350,000	450,000
	<hr/>	<hr/>
	\$500,000	\$500,000

2. Suppose a depositor in a bank in Lancaster, Pennsylvania, deposits a check on a Hartford, Connecticut, bank, which collects through Philadelphia, New York, and Boston. Make a time-table showing how long it would take to collect it and the shifts in the balances of the various banks involved.

3. Explain the paradox that checks are used more frequently in cities than in the country but that each check in the country passes through more hands.

4. In what ways is a system of large banks acting as correspondents for many small banks superior or inferior to a Federal reserve system or a system of large banks with branches scattered over the country? Consider the following points: local control, attention to needs of locality, distribution of credit, and control in time of crisis.

5. Explain how a bank determines the amount of balance it requires a bank to keep in return for acting as its correspondent.

6. Why does a bank ever wish to rediscount? Why was it formerly considered as a sign of weakness to rediscount?

7. Which gains the greater advantage from the correspondent relations: the larger or the smaller bank?

CHAPTER IX.

BANK ORGANIZATION AND MANAGEMENT.

The board of directors are chosen by stockholders and must be stockholders. They choose officers and are responsible for the general policy of the bank. The loan committee passes on loans and discounts.

The president, in small banks, is often little more than a figurehead. In large banks he often chooses the board of directors. He looks after the general policy and the general organization of the bank.

The vice-president is not important in small banks, except in the absence of the president. Large banks have numerous vice-presidents, who are department heads.

The cashier, in small banks, often runs everything. In large banks he is the chief executive officer. He keeps the minutes of the board, makes out the reports, employs the clerical help, and signs the checks.

The paying teller has charge of the cash, pays and certifies checks, prepares the payroll, and settles clearing house balances.

The receiving teller receives deposits and turns the items over to the proper departments: cash to the paying teller; clearing house checks to the clearing department; other local checks to the collection department; out-of-town checks to the transit department.

The discount clerk and note teller has custody of the notes and presents them for payment.

Problems of Bank Management.

1. The control of the personnel.
2. The care of the portfolio or the arrangement of loans.
3. Getting new business.
4. The management of the reserves.
5. The loaning policy with reference to the business cycle.

Materials on Chapter IX.

Investments of National Banks.

From the Report of the Comptroller of the Currency for 1921, p. 30.

[In thousands of dollars.]

	June 30, 1920.	June 30 1921.
Domestic securities:		
State, county, or other municipal bonds.....	338,357	393,682
.....	416,430	404,936
.....	283,118	277,205
All other bonds (domestic).....	309,755	352,405
Cash, United States bonds, etc.....	67,710	82,586
.....	145,901	159,766
.....	179,971	140,226
.....	60,954	63,513
.....	65,287	68,724
.....	49,407	62,541
Total.....	1,916,890	2,005,584
United States bonds (other than Liberty bonds)	1,815,426	} 2,019,497
Liberty loan bonds and Victory notes.....	1,454,149	
Total bonds of all classes.....	4,186,465	4,025,081

1. Includes United States certificates of indebtedness.
2. Excludes all United States Government securities.

National Bank Investments in United States Government Securities
and Other Bonds and Securities, etc., Loans and Discounts
(Including Rediscounts), and Losses Charged Off on Ac-
count of Bonds and Securities, etc., and Loans and
Discounts, Years Ended June 30, 1918 to 1921,
Inclusive.

From the Report of the Comptroller of the Currency for 1921, p. 58.

[In thousands of dollars.]

Year ended June 30.	United States Govern- ment securities.	Other bonds and securities.	Total bonds and securities, etc.	Loans and discounts including rediscounts.	Losses charged off on loans and dis- counts.	Losses charged off on bonds and se- curities, etc.	Percent- age of losses charged off on account loans and dis- counts to total loans and dis- counts.	Percent- age of losses charged off on bonds and se- curities to total bonds and se- curities
1918.....	2,129,283	1,840,487	3,969,770	10,135,842	33,964	44,350	.34	1.12
1919.....	3,176,314	1,875,609	5,051,923	11,010,206	35,440	27,819	.32	.55
1920.....	2,280,575	1,916,890	4,186,465	13,611,416	31,284	61,790	.23	1.43
1921.....	2,019,497	2,005,584	4,025,081	12,004,515	76,210	76,179	.63	1.89

Number of National Banks, Their Capital, Surplus, Dividends,
Net Addition to Profits, and Ratios, Years Ended June 30,
1914 to 1921.

From the Report of the Comptroller of the Currency for 1921, p. 58.

[In thousands of dollars.]

Yearended June 30.	Num- ber of banks.	Capital.	Surplus.	Dividends.	Net addition to profits.	Percentages.		
						Divi- dends to capital.	Divi- dends to capital and surplus	Net addi- tion to profits to cap- ital and surplus.
1914	7,453	1,063,978,175	714,117,131	120,947,096	149,270,171	11.37	6.80	8.39
1915	7,380	1,068,577,080	726,620,202	113,707,065	127,094,709	10.63	6.33	7.98
1916	7,571	1,065,208,875	731,820,365	114,724,594	157,543,547	10.76	6.38	8.76
1917	7,589	1,081,670,000	765,918,000	125,538,000	194,321,000	11.61	6.79	10.52
1918	7,691	1,098,261,000	816,801,000	129,778,000	212,332,000	11.82	6.78	11.09
1919	7,762	1,115,507,000	869,457,000	135,588,000	240,366,000	12.15	6.83	12.11
1920	8,019	1,221,453,000	984,977,000	147,793,000	282,083,000	12.10	6.70	12.78
1921	8,147	1,273,237,000	1,026,270,000	158,158,000	216,106,000	12.42	6.88	9.46

Earnings, Expenses, and Dividends of National Banks by Federal Reserve Districts, Year Ended June 30, 1921.

From the Report of the Comptroller of the Currency for 1921, p. 56.

[In thousands of dollars.]

	District No. 1. banks.	District No. 2. banks.	District No. 3. banks.	District No. 4. banks.	District No. 5. banks.	District No. 6. banks.	District No. 7. banks.	District No. 8. banks.	District No. 9. banks.	District No. 10. banks.	District No. 11. banks.	District No. 12. banks.	Non- member banks.	Grand total banks.
Capital.....	102,032	213,049	88,930	122,046	89,197	54,771	175,125	65,443	65,500	84,526	73,775	106,334	700	1,273,237
Surplus.....	85,215	270,609	125,383	105,061	65,488	37,639	114,108	32,365	37,180	48,191	43,517	51,973	455	1,026,270
Capital and surplus.....	187,150	519,658	214,312	227,107	154,685	92,409	289,233	97,808	102,680	132,717	117,322	161,307	1,155	2,299,507
Gross earnings:														
(a) Interest and discount.....	74,039	209,962	82,989	97,218	81,178	45,583	147,644	44,712	61,811	80,162	55,808	84,285	411	1,105,832
(b) Domestic exchange and collection.....	1,365	4,348	866	1,310	1,390	1,771	2,897	802	1,236	1,346	1,782	1,014	42	20,439
(c) Foreign exchange profits.....	2,080	13,482	1,438	1,267	1,337	201	1,644	97	252	68	28	1,378	.....	21,472
(d) Commissions and earnings from insurance premiums and the negotiation of real estate loans, authorized by the act of September 7, 1916, in towns of 5,000 population or less.....	1	8	25	10	40	4	216	22	622	119	22	94	8	1,191
(e) Other earnings.....	4,905	14,603	3,042	7,417	2,246	2,049	4,931	1,617	1,843	3,289	2,063	4,949	31	52,985
Total.....	82,390	302,403	88,360	107,222	84,991	49,578	156,402	47,250	65,764	84,984	59,763	92,320	492	1,201,919
Expenses paid:														
(a) Salaries and wages.....	11,830	42,897	13,084	16,749	11,321	9,479	25,230	8,607	12,460	17,963	13,173	19,892	131	202,726
(b) Interest and discount on borrowed money.....	3,882	35,260	7,149	4,665	7,812	7,026	18,233	5,018	6,636	8,406	7,043	8,261	.....	119,396
(c) Interest on deposits.....	21,634	72,942	22,675	30,584	16,236	10,225	37,042	10,324	20,224	19,569	10,291	19,965	57	291,828
(d) Taxes.....	6,911	20,841	4,487	7,578	4,490	3,981	12,390	3,418	4,980	6,870	5,312	6,111	20	87,398
(e) Contributions to American National Red Cross.....	8,610	28,934	8,496	12,403	6,515	6,049	14,810	4,930	7,468	11,040	7,876	11,231	69	123,371
(f) Other expenses.....	52,887	200,885	55,835	71,999	46,383	36,766	107,736	32,303	51,775	63,853	43,701	65,496	307	823,906
Total.....	29,523	101,518	32,525	35,223	13,608	12,812	48,666	14,947	13,989	21,131	16,082	26,824	185	372,013
Net earnings since last report (difference between totals of items 1 and 2).....	1,073	7,228	1,118	1,770	708	799	2,676	904	1,124	1,947	2,496	2,122	8	23,978
Recoveries on charged-off assets.....	30,601	108,746	33,643	36,993	19,316	13,611	51,342	15,851	15,113	23,078	18,558	28,946	193	305,991
Total.....														

Net earnings since last report (difference between totals of items 1 and 2).

Recoveries on charged-off assets.

Suggested Readings on Chapter IX.

Langston, L. H.—Practical Bank Operation.

Willis, H. P., and Edwards, G. W.—Banking and Business,
Chapters IX, X, and XIII.

Questions and Problems on Chapter IX.

1. Which officer of a bank would you prefer to be? Consider salary, responsibility, and pleasantness of occupation.
2. If you were a bank manager, where would you place a gruff man? A good mixer? A good detail man? A fast money counter? A very honest man?
3. Make an organization chart of a bank. Draw lines indicating the simple operations such as depositing money, cashing a check, getting a loan, and buying a draft.
4. Why do banks often give their employees bonuses? Is the policy wise?
5. Why do banks often provide lunch for their employees?
6. What would be the ideal portfolio for a bank?
7. How much of its assets can a bank afford to tie up in non-liquid investments?
8. Is it wise for a bank to put up a building for its own exclusive use? To put up a big office building and rent part of it?
9. How can a bank get new depositors?
10. Why do most banks grow through amalgamations instead of by getting new business?
11. What should be the character of bank advertising?
12. How can a banker arrange his portfolio so he need never worry about reserves?
13. Suggest the problems of the banker at each stage of the business cycle.
14. Suppose it is summer-time in an agricultural region. A bank has loaned all that its customers desire and has \$100,000 surplus funds. How should it invest it? Suppose it is a New York bank and the time is January 30. How should it invest it?
15. In a period of rapid expansion of business, does the individual banker need to consider the credit situation except as it affects the ability of his borrowers to meet their obligations? What would be the effect if the banker restricted his loans?
16. List the investments of national banks according to the amounts held. Does the banking correspond to their merits as investments?
17. What effect did the war have on earnings and dividends of the banks?

18. Do banks earn more in periods of prosperity or of depression?

19. How do the earnings of banks compare with those in other lines of business?

20. In which Federal reserve district was the ratio of earnings to capital and surplus highest?

21. Figure the percentage of gross earnings taken by expenses. How does this compare with other businesses?

22. How does the percentage of losses on loans and discounts of the banks compare with the credit losses of mercantile firms?

CHAPTER X.

SAVINGS BANKS.

The function of savings banks is to gather small savings from many people and make the combined amounts available for investment.

Forms of Organization.

1. Stock. A corporation is formed to operate the bank. Its capital and surplus act as a protection to the depositors. The stockholders divide the profits in the form of dividends on their stock.
2. Mutual. Trustees who serve without pay conduct the business of the bank. The earnings after setting aside reserves are paid to the depositors.
3. Guaranty banks. In New Hampshire, the mutual type is modified by the acceptance of special deposits which act as a guaranty fund for the ordinary deposits and in return get the earnings above the stipulated rate paid to depositors.
4. Departments in commercial banks and trust companies. These banks accept savings deposits as well as commercial accounts.
5. Postal savings banks. These are run by the Post Office Department. They appeal primarily to people who do not have confidence in the other banks.

Character of Accounts of Savings Banks.

1. Less active than checking accounts.
2. Funds are often accumulated for emergencies.

Character of Investments of Savings Banks.

Long-time investments are held:

1. To save the trouble of reinvesting.
2. To get a higher return.

Materials on Chapter X.
Number of Mutual Savings Banks, Number of Depositors, Aggregate Deposits, and Average Deposit Account, by States, June 30, 1920, and June 30, 1921.
From the Report of the Comptroller of the Currency for 1921, p. 147.

States.	1920					1921				
	Number of banks.	Depositors.	Deposits. ¹	Average to each depositor.	Per cent rate of interest paid.	Number of banks.	Depositors.	Deposits. ¹	Average to each depositor.	Per cent rate of interest paid.
Alabama.....	43	255,277	\$103,473	\$405.34	3.04	42	237,556	\$106,033	\$448.75	3.96
Arizona.....	45	257,627	113,731	529.87	3.00	45	230,534	120,157	531.21	4.00
Arkansas.....	46	172,126	68,757	530.25	3.00	46	192,627	66,655	548.56	4.26
California.....	106	2,600,640	1,188,828	457.13	3.43	107	2,574,169	1,233,870	480.10	4.54
Colorado.....	15	179,573	113,200	630.38	4.00	15	182,195	118,051	647.94	4.00
Connecticut.....	80	717,405	415,585	579.29	4.00	80	767,013	419,753	533.35	4.00
Total New England States.....	399	4,102,108	2,004,577	488.67	.....	399	4,134,094	2,067,089	500.01	.....
Delaware.....	141	3,770,482	2,398,320	638.08	3.00	143	3,854,000	2,485,251	687.13	3.00
District of Columbia.....	47	364,771	192,024	596.75	3.50	48	357,545	183,254	572.54	3.75
Florida.....	10	544,753	292,074	536.16	3.00 to 4.25	10	559,025	307,241	549.60	3.00 to 4.25
Georgia.....	2	44,000	18,738	425.86	4.00	2	43,416	19,238	443.11	4.00
Idaho.....	17	275,442	123,536	448.50	3.50	17	278,259	126,686	455.23	3.50
Total Eastern States.....	197	5,017,084	3,025,698	603.09	.....	198	5,092,331	3,284,670	645.02	.....
Illinois.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Indiana.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Iowa.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Kansas.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Michigan.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Minnesota.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Missouri.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Montana.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Nebraska.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Nevada.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
New Hampshire.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
New Jersey.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
New York.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
North Carolina.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Ohio.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Oklahoma.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Pennsylvania.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Rhode Island.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
South Carolina.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
South Dakota.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Tennessee.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Texas.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Vermont.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Virginia.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Washington.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
West Virginia (total Southern States).....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Wisconsin.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Wyoming.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Total Middle Western States.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Utah.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Washington, California.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Total Pacific States.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Idaho.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Montana.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
North Dakota.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
South Dakota.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Utah.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Wyoming.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Total United States.....	620	9,446,327	5,186,845	549.14	.....	623	9,619,260	5,575,181	579.59	.....

¹ Includes 1 stock savings bank.
² Includes \$19,866,000 deposits in 1 stock savings bank reported separately in 1921.
³ Jan. 1, 1921.
⁴ In thousands of dollars.
⁵ Generally.
⁶ Approximately.

Summary of Reports of Condition of 978 Stock Savings Banks in the United States at the Close of Business, June 30, 1921.

From the Report of the Comptroller of the Currency for 1921, p. 142.

RESOURCES

Loans and discounts:

On demand (secured by collateral other than real estate).....	\$12,101,000
On demand (not secured by collateral).....	1,521,000
On time (secured by collateral other than real estate)...	3,754,000
On time (not secured by collateral).....	9,123,000
Secured by farm land.....	7,718,000
Secured by other real estate.....	16,308,000
Not classified.....	379,062,000

Total.....\$429,587,000

Overdrafts.....361,000

Investments (including premiums on bonds):

United States Government securities.....	\$28,645,000
State, county, and municipal bonds.....	3,564,000
Railroad bonds.....	12,171,000
Bonds of other public service corporations (including street and interurban railway bonds).....	5,206,000
Other bonds, stocks, warrants, etc.....	8,191,000

Total.....57,777,000

Banking house (including furniture and fixtures).....14,611,000

Other real estate owned.....1,500,000

Due from banks.....41,453,000

Lawful reserve with Federal reserve bank or other reserve agents.....692,000

Checks and other cash items.....87,000

Exchanges for clearing house.....304,000

Cash on hand:

Gold coin.....	\$153,000
Silver coin.....	7,000
Paper currency.....	821,000
Nickels and cents.....	64,000
Cash not classified.....	9,968,000

Total.....11,013,000

Other resources.....525,000

Total resources.....557,910,000

LIABILITIES.

Capital stock paid in.....39,902,000

Surplus.....19,210,000

Undivided profits (less expenses and taxes paid).....9,216,000

Due to all banks.....393,000

Individual deposits (including postal savings):

Demand deposits—

Individual deposits subject to check.....	\$12,848,000
Demand certificates of deposit.....	1,250,000
Certified checks and cashiers' checks.....	226,000
Dividends unpaid.....	49,000

Time deposits—

Savings deposits or deposits in interest or savings department.....	304,386,000
Time certificates of deposit.....	2,271,000

Postal savings deposits.....4,000

Deposits not classified.....122,043,000

Total.....443,077,000

United States deposits (exclusive of postal savings).....110,000

Notes and bills rediscounted.....86,000

Bills payable (including certificates of deposit representing money borrowed).....40,411,000

Other liabilities.....5,505,000

Total liabilities.....557,910,000

**Summary of Reports of Condition of 623 Mutual Savings Banks in
the United States at the Close of Business, June 30, 1921.**

From the Report of the Comptroller of the Currency for 1921,

pp. 144-145.

RESOURCES.

Loans and discounts:

On demand (secured by collateral other than real estate).....	\$54,458,000
On demand (not secured by collateral).....	8,957,000
On time (secured by collateral other than real estate).....	143,954,000
On time (not secured by collateral).....	94,217,000
Secured by farm land.....	20,286,000
Secured by other real estate.....	2,439,798,000
Not classified.....	48,128,000

Total.....	\$2,809,798,000
Overdrafts.....	7,000

Investments (including premiums on bonds):

United States Government securities.....	\$908,528,000
State, county, and municipal bonds.....	640,152,000
Railroad bonds.....	887,507,000
Bonds of other public service corporations (including street and interurban railway bonds).....	115,651,000
Other bonds, stocks, warrants, etc.....	337,133,000

Total.....	2,888,971,000
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Banking house (including furniture and fixtures).....	\$46,171,000
Other real estate owned.....	11,700,000
Due from banks.....	163,043,000
Lawful reserve with Federal reserve bank or other reserve agents....	8,699,000
Checks and other cash items.....	2,539,000
Exchanges for clearing house.....	160,000

Cash on hand:	
Gold coin.....	\$1,090,000
Silver coin.....	178,000
Paper currency.....	18,977,000
Nickels and cents.....	26,000
Cash not classified.....	17,158,000

Total.....	37,429,000
Other resources.....	71,604,000

Total resources.....	<u>6,040,121,000</u>
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LIABILITIES.

Surplus.....	366,420,000
Undivided profits (less expenses and taxes paid).....	79,920,000
Due to all banks.....	135,000

Individual deposits (including postal savings):

Demand deposits—	
Individual deposits subject to check.....	\$137,882,000
Demand certificates of deposit.....	30,336,000
Certified checks and cashiers' checks.....	34,000
Time deposits—	
Savings deposits, or deposits in interest or savings department.....	5,394,963,000
Time certificates of deposit.....	589,000
Postal savings deposits.....	39,000
Deposits not classified.....	11,338,000

Total.....	5,575,181,000
United States deposits (exclusive of postal savings).....	2,000
Notes and bills rediscounted.....	91,000
Bills payable (including certificates of deposit representing money borrowed).....	764,000
Other liabilities.....	17,608,000

Total liabilities.....	<u>6,040,121,000</u>
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Balance Sheet Showing Comparatively the Resources and Liabilities of Postal Savings System on June 30, 1921, and June 30, 1920, the Increase or Decrease in Each Item During the Period Reported, and Related Data.

From the Report of the Comptroller of the Currency for 1921, p. 180.

Items.	June 30, 1921.		June 30, 1920.		Increase (+). Decrease (-).
RESOURCES.					
Working cash:					
Depository banks.....	\$42,478,899.28		\$124,146,727.34		-375,667,828.06
Postmasters.....	110,059.00		219,158.79		- 109,099.79
		\$48,588,958.28		\$124,365,886.13	- 75,776,927.85
Special funds:					
Treasurer of the United States—					
Reserve fund.....	3,953,990.44		7,698,280.21		- 3,714,289.77
Returnable deposits fund.....	67,094.21		10,911.00		+ 56,183.21
Bond investment fund.....	29,687.04				+ 29,687.04
Bond purchase fund.....			72,800.00		- 72,800.00
		4,080,771.69		7,781,991.21	- 3,701,219.52
Accounts receivable:					
Accrued interest on bond investments.	1,071,701.59		352,246.97		+ 719,454.62
Due from discontinued depository banks.....	1.55		.33		+ 1.22
Due from late postmasters, including credits temporarily withheld.....	103,886.71		25,326.92		+ 78,559.79
		1,175,589.85		377,574.22	+ 798,015.63
Investments, carried at cost price (U. S. bonds), par value \$118,758,330:					
\$7,469,580 postal savings 2½s.....	7,469,580.00		6,573,420.00		+ 896,160.00
\$375,000 first Liberty 4½s.....	323,925.82				+ 323,925.82
\$15,237,000 second Liberty 4½s.....	13,338,829.12				+ 13,338,829.12
\$14,000,000 third Liberty 4½s.....	13,440,500.00		13,440,500.00		
\$81,576,750 fourth Liberty 4½s.....	71,095,969.68		10,524,800.00		+ 60,571,169.68
		105,668,804.62		30,538,720.00	+ 75,130,084.62
		159,514,124.44		163,064,171.56	- 3,550,047.12
LIABILITIES.					
Due depositors:					
Outstanding principal, represented by certificates of deposit.....	152,359,903.00		157,276,322.00		- 4,886,419.00
Interest payable on certificates of deposit.....	2,561,420.15		2,453,975.21		+ 107,444.94
Outstanding savings cards and stamps.....	56,220.50		59,119.90		- 2,899.40
Unclaimed deposits.....			10.00		- 10.00
		155,007,543.65		159,789,427.11	- 4,781,883.46
Accounts payable:					
Due Postal Service—Interest and profits		235,367.04		5,783.54	+ 229,583.50
Surplus funds:					
Interest and profits (profit and loss) subject to future allocation of maturing interest charges.....		4,271,213.75		3,268,960.91	+ 1,002,252.84
		159,514,124.44		163,064,171.56	- 3,550,047.12

Summary of Postal Savings Business for the Fiscal Year Ended June 30, 1921, by States. From the Report of the Comptroller of the Currency for 1921, pp. 182-183.

States.	Balance to the credit of depositors June 30, 1920.	Deposits. ¹	Withdrawals. ¹	Balance to the credit of depositors June 30, 1921.	Increase in balance to the credit of depositors. ²	Savings cards and stamps.	Amount at interest in banks including outstanding items.	Interest received from banks.	Interest paid to depositors.	Amount of deposits surrendered for bonds.
	\$157,276,322	\$133,858,839	\$138,745,258	\$152,389,903	—\$4,890,419	\$60,023.60	\$22,923	\$2,068,907.61	\$2,127,600.24	\$178,880
United States.....	508,748	530,812	557,801	481,659	—	37.30	35	124,613.12	6,408.70	.....
Alabama.....	434,311	585,016	387,136	685,131	240,829	1.40	1	9,111.73	5,335.32	.....
Alaska.....	374,600	177,374	983,107	576,229	201,169	40.80	30	292,121.49	6,870.46	.....
Arizona.....	136,871	172,311	231,396	231,396	10,725	4.40	9	5,712.80	2,688.74	560
Arkansas.....	3,419,872	3,515,730	3,320,465	3,595,563	138,000	202.60	234	681,093.52	53,782.46	8,160
California.....	1,617,063	2,174,010	1,892,482	1,742,692	85,210	198.30	179	531,083.08	28,126.00	3,000
Colorado.....	3,616,963	2,474,010	3,456,632	2,743,092	902,111	735.50	1,121	428,457.80	56,167.46	1,500
Connecticut.....	388,870	358,530	326,430	413,870	75,000	157.60	172	85,273.84	5,385.08	.....
District of Columbia.....	437,960	315,825	368,812	219,991	217,991	258.80	277	374,710.97	5,809.44	1,820
Florida.....	795,468	1,114,010	998,702	910,770	115,308	62.80	47	375,355.50	5,389.90	1,100
Georgia.....	131,985	184,880	146,748	172,973	40,957	9.00	10	15,522.67	1,907.08	1,600
Hawaii.....	38,267	78,097	87,965	38,999	40,253	5.00	1	15,522.67	453.36	.....
Idaho.....	320,621	533,723	391,816	432,537	111,916	16.50	6	237,157.07	5,327.84	.....
Illinois.....	10,419,179	6,387,511	7,261,818	9,544,875	874,304	335.80	498	2,931,813.65	156,064.66	6,000
Indiana.....	1,740,474	1,045,993	1,359,949	1,426,551	313,923	114.00	92	375,073.29	26,323.38	3,620
Iowa.....	387,673	286,390	285,602	391,567	3,894	95.10	79	147,757.11	6,074.22	500
Kansas.....	722,983	424,843	394,137	753,714	30,731	72.20	69	282,518.99	10,386.96	1,200
Kentucky.....	492,633	383,628	438,106	444,095	48,538	90.30	98	130,000.57	7,644.78	1,400
Louisiana.....	300,543	438,579	378,553	451,509	61,026	14.80	28	172,110.15	8,391.74	500
Maine.....	377,538	221,281	276,142	322,677	51,801	49.10	46	77,121.22	4,800.88	.....
Maryland.....	336,623	343,623	376,371	303,879	32,948	72.40	81	74,430.45	4,102.48	.....
Massachusetts.....	5,071,276	7,985,164	6,067,743	6,959,732	1,888,460	3,321.60	3,119	2,542,834.98	77,944.82	500
Michigan.....	6,290,239	4,793,592	6,660,700	4,393,041	1,897,198	360.10	393	1,483,818.79	72,231.86	11,900
Minnesota.....	2,320,158	1,226,348	1,011,399	1,035,128	385,030	97.00	79	490,087.87	38,652.00	5,100
Mississippi.....	81,414	76,292	56,073	101,633	25,219	27.50	30	61,404.37	1,527.44	.....
Missouri.....	2,362,911	2,982,911	2,222,846	3,020,398	40,098	156.40	127	970,536.16	41,218.95	3,000
Montana.....	1,001,769	705,123	805,911	900,893	100,816	24.30	25	270,827.57	17,560.60	1,800
Nebraska.....	388,489	301,670	299,163	390,996	2,507	87.50	66	128,525.75	6,087.16	1,300
Nevada.....	377,769	452,418	477,035	353,142	24,617	6.10	5	93,974.00	4,935.98	1,000
New Hampshire.....	564,599	412,077	419,514	557,762	6,877	373.40	384	161,504.07	5,210.92	2,000
New Jersey.....	6,404,504	4,903,068	5,709,541	5,693,629	800,875	3,333.00	3,708	1,290,676.99	87,865.58	7,000
New Mexico.....	62,600	54,390	45,012	72,028	9,368	1.40	5	34,158.65	1,124.32	2,000
New York.....	65,895,838	59,203,652	58,462,417	66,607,073	741,235	28,038.30	28,149	21,801,511.72	774,963.96	43,840
North Dakota.....	42,571	43,070	41,335	44,106	1,535	22.60	19	15,151.66	778.52	.....
Ohio.....	11,374	25,193	16,940	20,627	9,233	683.60	688	14,010.03	236.50	.....
North Carolina.....	7,121,271	4,577,107	6,192,310	5,406,038	1,615,233	983.60	29	1,439,918.75	111,354.90	17,500
Oklahoma.....	282,900	340,834	322,076	311,709	1,18,809	30.20	29	103,918.75	3,773.20	.....

Summary of Postal Savings Business for the Fiscal Year Ended June 30, 1921, by States—Continued.

Oregon.....	2,270,897	1,833,599	1,906,702	2,146,794	—	133,103	85.50	102	730,039.72	30,471.84	36,704.12	12,200
Pennsylvania.....	17,063,594	12,348,716	13,852,266	15,570,044	—	1,403,559	3,931.00	4,385	4,353,584.34	226,477.59	247,597.08	23,140
Puerto Rico.....	136,728	310,354	278,491	168,089	—	31,563	14,306.80	15,359	118,681.07	2,827.07	833.12	—
Rhode Island.....	1,361,755	1,015,099	1,250,539	1,131,381	—	236,477	1,523.50	1,640	215,563.41	15,919.79	18,522.34	500
South Carolina.....	31,569	27,410	26,698	37,584	—	270	3.70	4	19,700.93	811.46	910.08	—
South Dakota.....	206,680	248,421	261,017	282,238	—	14,432	53.50	47	13,657.04	4,263.87	3,934.76	600
Tennessee.....	779,490	771,099	682,845	807,744	—	88,254	81.30	77	357,417.17	12,131.67	9,683.72	500
Texas.....	724,282	510,851	685,479	648,651	—	175,628	7.30	9	118,467.59	8,018.82	10,167.62	1,000
Utah.....	63,201	70,521	40,632	91,184	—	38,889	4.90	7	59,593.44	1,153.48	769.62	—
Vermont.....	645,450	552,460	721,830	476,080	—	169,370	179.30	192	197,301.63	8,608.17	8,894.02	4,200
Virgin Islands.....	.....	3,189	704	2,416	—	2,416	3.00	3	—	—	—	—
Washington.....	4,671,438	5,355,855	4,286,951	5,740,472	—	1,069,034	95.60	83	2,405,242.20	72,361.88	71,542.04	5,000
West Virginia.....	408,488	430,702	403,276	435,911	—	27,426	24.50	21	136,650.80	5,822.59	5,314.76	—
Wisconsin.....	2,455,627	1,290,794	1,778,755	1,967,646	—	487,961	66.90	31	430,368.93	28,542.43	40,021.78	2,600
Wyoming.....	211,233	249,516	241,272	219,537	—	8,244	.40	1	83,074.33	3,179.87	3,060.70	—

1 These totals include the amount of \$233,999 transferred between depository offices.

2 A minus (—) sign denotes decrease.

Selected Sections from the Banking Law of New York.

§234. *Initial Guaranty Fund; Agreement of Incorporators to Contribute; Bond.*

Before any savings bank hereafter organized shall be authorized to do business in this State, its incorporators shall create a guaranty fund for the protection of its depositors against losses upon its investments whether arising from depreciation in the market value of its securities or otherwise.

1. Such guaranty fund shall consist of payments in cash made by the original incorporators and of sums credited thereto from the earnings of the savings bank as hereinafter required.

2. The incorporators shall deposit to the credit of such savings bank in cash as an initial guaranty fund at least five thousand dollars. They shall also enter into such agreement or undertaking with the superintendent of banks as trustee for the depositors with the savings bank as he may require, to make such further contributions in cash to the guaranty fund of such savings bank as may be necessary to maintain the solvency of the savings bank and to render it safe for it to continue business. Such agreement or undertaking to an amount approved by the superintendent of banks shall be secured by a surety bond executed by a domestic or foreign corporation authorized by the superintendent of insurance to transact within this State the business of surety, and shall be filed in the banking department. Such agreement or undertaking and such surety bond need not be made or furnished unless the superintendent of banks shall require the same.

3. Prior to the liquidation of any such savings bank, such guaranty fund shall not be in any manner encroached upon, except for losses and the repayment of contributions made by incorporators or trustees as hereinafter provided, until it exceeds twenty-five per centum of the amount due depositors.

4. The amounts contributed to such guaranty fund by the incorporators or trustees shall not constitute a liability of the savings bank, except as hereinafter provided, and any losses sustained by the savings bank in excess of that portion of the guaranty fund created from earnings may be charged against such contributions pro rata.

§235. *Expense Fund; Agreement of Incorporators to Contribute; Bond.*

Before any savings bank hereafter organized shall be authorized to do business in this State, its incorporators shall create an expense fund from which the expense of organizing such savings bank and its operating

expenses may be paid until such time as its earnings are sufficient to pay its operating expenses in addition to such dividends as may be declared and credited to its depositors from its earnings.

The incorporators shall deposit to the credit of such savings bank in cash as an expense fund the sum of five thousand dollars. They shall also enter into such an agreement or undertaking with the superintendent of banks as trustee for the depositors with the savings bank as he may require, to make such further contributions in cash to the expense fund of such savings bank as may be necessary to pay its operating expenses until such time as it can pay them from its earnings in addition to such dividends as may be declared and credited to its depositors. Such agreement or undertaking, to an amount approved by the superintendent of banks, shall be secured by a surety bond executed by a domestic or foreign corporation authorized by the superintendent of insurance to transact within this State the business of surety, and shall be filed in the banking department. Such agreement or undertaking and such surety bond need not be made or furnished unless the superintendent of banks shall require the same.

The amounts contributed to the expense fund of such savings bank by the incorporators or trustees shall not constitute a liability of such savings bank, except as hereinafter provided.

§236. Return of Initial Guaranty Fund and Expense Fund.

1. Contributions made by the incorporators or trustees to the expense fund may be repaid pro rata to the contributors from that portion of the guaranty fund created from earnings, whenever such payments will not reduce the guaranty fund below five per centum of the total amount due depositors. In case of the liquidation of the savings bank before such contributions to the expense fund have been repaid, any contributions to the expense fund remaining unexpended after the payment of the expenses of liquidation may be repaid to the contributors pro rata.

2. Whenever the contributions of the incorporators or trustees to the expense fund of such savings bank have been returned to them, the contributions made to the guaranty fund by incorporators or trustees may be returned to them pro rata, from that portion of the guaranty fund created from the earnings of the savings bank, provided that such repayments will not reduce the earned portion of the guaranty fund of such savings bank below five per centum of the amount due depositors. In case of the liquidation of the savings bank before such contributions to the guaranty fund have been repaid, any portion of such contribu-

tions not needed for the payment of the expenses of liquidation and the payment of depositors in full and the repayment of contributions to the expense fund may be repaid to the contributors pro rata.

§238. *General Powers.*

In addition to the powers conferred by the general corporation law, every savings bank shall have, subject to the restrictions and limitations contained in this article, the following powers:

1. To receive deposits of money, to invest the same in the property and securities prescribed in section two hundred and thirty-nine of this article, to declare dividends in the manner prescribed in sections two hundred and fifty-four to two hundred and fifty-six of this article, and to exercise by its board of trustees or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of a savings bank.

2. To issue transferable certificates showing the amounts heretofore or hereafter contributed by any incorporator or trustee for the purpose of maintaining the solvency of such savings bank, or for the purpose of paying its expenses. Such certificate shall show that it does not constitute a liability of such savings bank, except as hereinbefore provided.

3. To purchase, hold and convey real property as prescribed in sections two hundred and thirty-nine and two hundred and forty of this article.

4. To pay depositors as hereinafter provided and, when requested by them, by drafts upon deposits to the credit of the savings bank in the city of New York or in foreign exchange, and to charge current rates of exchange for such drafts.

5. To borrow money for the purpose of purchasing the stocks or bonds on interest-bearing notes or obligations of the United States or, in an emergency for the purpose of repaying depositors and to pledge or hypothecate securities as collateral for any loans so obtained.

6. To collect or protest promissory notes or bills of exchange and remit the proceeds of the collections by drafts upon deposits to the credit of the savings bank in the city of New York, and to charge the usual rates or fees for such collection and remittance or such protest.

7. To sell gold or silver received in payment of interest or principal of obligations owned by the savings bank, or from depositors in the regular course of business.

8. To receive as depositary, or as bailee for safekeeping and storage, liberty bonds or other bonds or securities issued by the United States Government for war purposes or otherwise.

9. To [do] all other acts authorized by this article.

10. To receive money for transmission and to forward the same through any bank, national banking association or trust company incorporated under the laws of the State of New York or under the laws of the United States and having its principal place of business in the State of New York and which is regularly engaged in the business of transmitting money, subject to the same regulations and limitations as are prescribed for private bankers in respect thereto pursuant to sections one hundred and sixty-seven and one hundred and sixty-eight of this chapter.

§239. Investments of Deposits and Guaranty Fund and Restrictions Thereon.

A savings bank may invest the moneys deposited therein, the sums credited to the guaranty fund thereof and the income derived therefrom, in the following property and securities and no others, and subject to the following restrictions:

1. The stocks or bonds or interest-bearing notes or obligations of the United States, or those for which the faith of the United States is pledged to provide for the payment of the interest and principal, including the bonds of the District of Columbia.

2. The stocks or bonds or interest-bearing obligations of this State, issued pursuant to the authority of any law of the State.

3. The stocks, bonds or interest-bearing obligations of any State of the United States, upon which there is no default and upon which there has been no default for more than ninety days; provided that within ten years immediately preceding the investment such State has not been in default for more than ninety days in the payment of any part of principal or interest of any debt duly authorized by the legislature of such State to be contracted by such State since the first day of January, eighteen hundred and seventy-eight.

4. The stocks, bonds, interest-bearing obligations, or revenue notes sold at a discount, of any city, county, town, village, school district, union free school district or poor district in this State, provided that they were issued pursuant to law and that the faith and credit of the municipality or district that issued them are pledged for their payment.

5. (a) The stocks or bonds of any incorporated city, county, village or town, situated in one of the States of the United States which adjoins the State of New York. If at any time the indebtedness of any such city, town or village, together with the indebtedness of any district or other municipal corporation or subdivision, except a county, which is wholly or in part included within the boundaries or limits

of said city, town or village less its water debt and sinking fund, or the indebtedness of any such county, less its sinking fund, shall exceed seven per centum of the valuation of said city, county, town or village for the purpose of taxation, its bonds and stocks shall thereafter, until such indebtedness shall be reduced to seven per centum of the valuation for the purposes of taxation, cease to be an authorized investment for the moneys of savings banks.

(b) The stocks or bonds of any incorporated city situated in any other of the States of the United States which was admitted to statehood prior to January first, eighteen hundred and ninety-six, and which since January first, eighteen hundred and sixty-one, has not repudiated or defaulted in the payment of any part of the principal or interest of any debt authorized by the legislature of any such State to be contracted, provided said city has a population, as shown by the Federal census next preceding said investment, of not less than forty-five thousand inhabitants, and was incorporated as a city at least twenty-five years prior to the making of said investment, and has not, since January first, eighteen hundred and seventy-eight, defaulted for more than ninety days in the payment of any part either of principal or interest of any bond, note or other evidence of indebtedness, or effected any compromise of any kind with the holders thereof. But if, after such default on the part of any such State or city, the debt or security, in the payment of the principal or interest of which such default occurred, has been fully paid, refunded or compromised by the issue of new securities then the date of the first failure to pay principal or interest, when due, upon such debt or security, shall be taken to be the date of such default, within the provisions of this subdivision, and subsequent failures to pay installments of principal or interest upon such debt or security, prior to the refunding or final payment of the same, shall not be held to continue said default or to fix the time thereof, within the meaning of this subdivision, at a date later than the date of said first failure in payment. If at any time the indebtedness of any such city, together with the indebtedness of any district, or other municipal corporation or subdivision except a county, which is wholly or in part included within the bounds or limits of said city, less its water debt and sinking funds shall exceed seven per centum of the valuation of said city for purposes of taxation, its bonds and stocks shall thereafter, and until such indebtedness shall be reduced to seven per centum of the valuation for the purposes of taxation, cease to be an authorized investment for the moneys of savings banks.

6. Bonds and mortgages on unincumbered real property situated in this State, to the extent of sixty per centum of the appraised value

thereof. Not more than sixty-five per centum of the whole amount of deposits and guaranty fund shall be so loaned or invested. If the loan is on unimproved and unproductive real property, the amount loaned thereon shall not be more than forty per centum of its appraised value. No investment in any bonds and mortgages shall be made by any savings bank except upon the report of a committee of its trustees charged with the duty of investigating the same, who shall certify to the value of the premises mortgaged or to be mortgaged, according to their judgment, and such report shall be filed and preserved among the records of the corporation. For the purposes of this subdivision real property on which there is a building in process of construction, which when completed will constitute a permanent improvement, shall be considered improved and productive real property.

7. The following bonds of railroad corporations:

(a) The first mortgage bonds of any railroad corporation of this State, the principal part of whose railroad is located within this State, or of any railroad corporation of this or any other State or States connecting with and controlled and operated as a part of the system of any such railroad corporation of this State, and of which connecting railroad at least a majority of its capital stock is owned by such a railroad corporation of this State, or in the mortgage bonds of any such railroad corporation of an issue to retire all prior mortgage debt of such railroad companies respectively; provided that at no time within five years next preceding the date of any such investment, such railroad corporation of this State or such connecting railroad corporation respectively shall have failed regularly and punctually to pay the matured principal and interest of all its mortgage indebtedness, and in addition thereto regularly and punctually to have paid in dividends to its stockholders during each of said five years an amount at least equal to four per centum upon all its outstanding capital stock; and provided, further, that at the date of every such dividend the outstanding capital stock of such railroad corporation, or such connecting railroad company respectively shall have been equal to at least one-third of the total mortgage indebtedness of such railroad corporations respectively, including all bonds issued or to be issued under any mortgage securing any bonds in which such investment shall be made. If by means of consolidation a railroad corporation shall own and possess the properties and franchises which prior thereto belonged to similar corporations, and if the outstanding capital stock of the railroad corporation formed by such consolidation shall be equal to at least one-third of the total mortgage indebtedness of such railroad corporation, including all bonds issued or to be issued under any mortgage securing any bonds in which such investment shall be made,

and if during the five years next preceding such consolidation no one of the consolidating railroad corporations shall have failed regularly and punctually to pay the matured principal and interest of all its mortgage indebtedness, and if in addition thereto during the five years next preceding such consolidation, the dividends paid in cash by one or more of such consolidating corporations have equaled or exceeded four per centum upon an amount equal to the combined capital stock of the consolidating corporations outstanding at the time of each dividend payment during such five-year period, such successor railroad corporation formed by such consolidation shall be considered as having regularly and punctually paid such matured principal and interest and such dividends equal to or exceeding four per centum per annum during the same period of five years, provided further that the amount of dividends paid in cash during each of such five years equaled or exceeded four per centum per annum on the stock of the consolidated corporation as outstanding at the time of such consolidation.

(b) The mortgage bonds of the following railroad corporations: The Chicago and Northwestern Railroad Company; Chicago, Burlington and Quincy Railroad Company, Michigan Central Railroad Company, Illinois Central Railroad Company, Pennsylvania Railroad Company, Delaware and Hudson Company, Delaware, Lackawanna and Western Railroad Company, New York, New Haven and Hartford Railroad Company, Boston and Maine Railroad Company, Maine Central Railroad Company, the Chicago and Alton Railroad Company, Morris and Essex Railroad Company, Central Railroad of New Jersey, United New Jersey Railroad and Canal Company, also in the mortgage bonds of railroad companies whose lines are leased or operated or controlled by any railroad company specified in this paragraph if said bonds be guaranteed both as to principal and interest by the railroad company to which said lines are leased or by which they are operated or controlled. Provided that at the time of making investments authorized by this paragraph the said railroad corporations issuing such bonds shall have earned and paid regular dividends of not less than four per centum per annum in cash on all their issues of capital stock for the ten years next preceding such investment, and provided the capital stock of any said railroad corporations shall equal or exceed in amount one-third of the par value of all its bonded indebtedness; and further provided that all bonds authorized for investment by this paragraph shall be secured by a mortgage which is a first mortgage on either the whole or some part of the railroad and railroad property of the company issuing such bonds, or that such bonds shall be mortgage bonds of an issue to retire all prior mortgage debts of such railroad company; provided, further, that

the mortgage which secures the bonds authorized by this paragraph is dated, executed and recorded prior to January first, nineteen hundred and five.

(c) The mortgage bonds of the Chicago, Milwaukee and Saint Paul Railway Company, and the Chicago, Rock Island and Pacific Railway Company, so long as they shall continue to earn and pay at least four per centum dividends per annum on their outstanding capital stock, and provided their capital stock shall equal or exceed in amount one-third of the par value of all their bonded indebtedness, and further provided that all bonds of either of the said companies hereby authorized for investment shall be secured by a mortgage which is a first mortgage on either the whole or some part of the railroad or railroad property actually in the possession of and operated by said company, or that such bonds shall be mortgage bonds of an issue to retire all prior debts of said railroad company; provided, further, that the mortgage which secures the bonds authorized by this paragraph is dated, executed and recorded prior to January first, nineteen hundred and five.

(d) The first mortgage bonds of the Fonda, Johnstown and Gloversville Railroad Company, or in the mortgage bonds of said railroad company of an issue to retire all prior mortgage debts of said railroad company and provided the capital stock of said railroad company shall equal or exceed in amount one-third of the par value of all its bonded indebtedness and provided also that such railroad be the standard gauge of four feet eight and one-half inches, and in the mortgage bonds of the Buffalo Creek Railroad Company of an issue to retire all prior mortgage debts of said railroad company, provided that the bonds authorized by this paragraph are secured by a mortgage dated, executed and recorded prior to January first, nineteen hundred and five.

(e) The mortgage bonds of any railroad corporation incorporated under the laws of any of the United States, which actually owns in fee not less than five hundred miles of standard gauge railway exclusive of sidings, within the United States, provided that at no time within five years next preceding the date of any such investment such railroad corporation shall have failed regularly and punctually to pay the matured principal and interest of all its mortgage indebtedness and in addition thereto regularly and punctually to have paid in dividends to its stockholders during each of said five years an amount at least equal to four per centum upon all its outstanding capital stock; and provided further that during said five years the gross earnings in each year from the operations of said company, including therein the gross earnings of all railroads leased and operated or controlled and operated by said company, and also including in said earnings the amount received directly

or indirectly by said company from the sale of coal from mines owned or controlled by it, shall not have been less in amount than five times the amount necessary to pay the interest payable during that year upon its entire outstanding indebtedness, and the rentals for said year of all leased lines, and further provided that all bonds authorized for investment by this paragraph shall be secured by a mortgage which is at the time of making said investment or was at the date of the execution of said mortgage (one) a first mortgage upon not less than seventy-five per centum of the railway owned in fee by the company issuing said bonds exclusive of siding at the date of said mortgage or (two) a refunding mortgage issued to retire all prior lien mortgage debts of said company outstanding at the time of said investment and covering at least seventy-five per centum of the railway owned in fee by said company at the date of said mortgage. But no one of the bonds so secured shall be a legal investment in case the mortgage securing the same shall authorize a total issue of bonds which together with all outstanding prior debts of said company, after deducting therefrom in case of a refunding mortgage, the bonds reserved under the provisions of said mortgage to retire prior debts at maturity, shall exceed three times the outstanding capital stock of said company at the time of making said investment. And no mortgage is to be regarded as a refunding mortgage, under the provisions of this paragraph, unless the bonds which it secures mature at a later date than any bond which it is given to refund, nor unless it covers a mileage at least twenty-five per centum greater than is covered by any one of the prior mortgages so to be refunded.

(f) Any railroad mortgage bonds which would be a legal investment under the provisions of paragraph (e) of this subdivision, except for the fact that the railroad corporation issuing said bonds actually owns in fee less than five hundred miles of road, provided that during five years next preceding the date of any such investment the gross earnings in each year from the operations of said corporation, including the gross earnings of all lines leased and operated or controlled and operated by it, shall not have been less than ten million dollars.

(g) The mortgage bonds of a corporation described in the foregoing paragraph (e) or (f) or the mortgage bonds of a railroad owned by such corporation, assumed or guaranteed by it by indorsement on said bonds, provided said bonds are prior to and are to be refunded by a general mortgage of said corporation the bonds secured by which are made a legal investment under the provisions of said paragraph (e) or (f); and provided, further, that said general mortgage covers all the real property, upon which the mortgage securing said underlying bonds is a lien.

(h) Any railway mortgage bonds which would be a legal investment under the provisions of paragraph (e) or (g) of this subdivision except for the fact that the railroad corporation issuing said bonds actually owns in fee less than five hundred miles of road, provided the payment of principal and interest of said bonds is guaranteed by indorsement thereon by, or provided said bonds have been assumed by, a corporation whose first mortgage is, or refunding mortgage bonds are, a legal investment under the provisions of paragraph (e) or (f) of this subdivision. But no one of the bonds so guaranteed or assumed shall be a legal investment in case the mortgage securing the same shall authorize a total issue of bonds which, together with all the outstanding prior debts of the corporation making said guarantee or so assuming said bonds, including therein the authorized amount of all previously guaranteed or assumed bond issues, shall exceed three times the capital stock of said corporation, at the time of making said investment.

(i) The first mortgage bonds of a railroad the entire capital stock of which, except shares necessary to qualify directors, is owned by, and which is operated by a railroad whose last-issued refunding bonds are a legal investment under the provisions of paragraph (a), (e), or (f) of this subdivision, provided the payment of principal and interest of said bonds is guaranteed by indorsement thereon by the company so owning and operating said road, and further provided the mortgage securing said bonds does not authorize an issue of more than twenty thousand dollars in bonds for each mile of road covered thereby. But no one of the bonds so guaranteed shall be a legal investment in case the mortgage securing the same shall authorize a total issue of bonds which together with all the outstanding prior debts of the company making said guarantee, including therein the authorized amount of all previously guaranteed bond issues, shall exceed three times the capital stock of said company at the time of making said investment.

Bonds which have been or shall become legal investments for savings banks under any of the provisions of this section shall not be rendered illegal as investments, though the property upon which they are secured has been or shall be conveyed to another corporation, and though the railroad corporation which issued or assumed said bond has been or shall be consolidated with another railroad corporation, if the consolidated or purchasing corporation shall assume the payment of said bonds and shall continue to pay regularly interest or dividends or both upon the securities issued against, in exchange for or to acquire the stock of the company consolidated or the property purchased or upon securities subsequently issued in exchange or substitution therefor, to an amount at least equal to four per centum per annum upon the capital stock out-

standing at the time of such consolidation or purchase of said corporation which has issued or assumed such bonds.

Not more than twenty-five per centum of the assets of any savings bank shall be loaned or invested in railroad bonds, and not more than ten per centum of the assets of any savings bank shall be invested in the bonds of any one railroad corporation described in paragraph (a) of this subdivision, and not more than five per centum of such assets in the bonds of any other railroad corporation. In determining the amount of the assets of any savings bank under the provisions of this subdivision its securities shall be estimated in the manner prescribed for determining the per centum of par value surplus by section two hundred and fifty-seven of this article.

Street railroad corporations shall not be considered railroad corporations within the meaning of this subdivision.

The time during which any railroad is operated by the Government of the United States under the provisions of an act of Congress approved August twenty-ninth, nineteen hundred and sixteen, an act of Congress approved March twenty-first, nineteen hundred and eighteen, or any other act or acts of the Congress of the United States, and two years thereafter, and the earnings made and dividends paid during said time and said two years thereafter shall not be taken into consideration in determining whether the bonds of the railroad corporation comply with any of the provisions of this section. Any railroad corporation, which, at the time that the operation of its railroad by the Government of the United States under the provisions of such act or acts began had complied with the provisions of paragraph (e) of this subdivision for one or more years next preceding the commencement of such Government operation and control shall be entitled to include in computing the period of five years prescribed by the provisions of said paragraph (e) each year a portion of which its railroad shall have been operated by the Government of the United States under the provisions of such act or acts and the two years succeeding the termination of such operation, in determining whether such corporation has complied with the provisions of said paragraph (e) each year for five years as required by said paragraph. Except as hereinbefore provided, whenever a reference is made in this subdivision to a period of five years preceding the date of an investment in the bonds of any railroad corporation, such period shall be deemed exclusive of any time during which the property of such railroad corporation has been operated by the Government of the United States under the provisions of such act or acts and of the two years succeeding the termination of such operation. Any bonds acquired prior to the passage of this amendment and at any time hereafter which comply

with the provisions of this section as amended may, so long as they continue to comply herewith, be retained as investments authorized by law.

8. (a) Promissory notes payable to the order of the savings bank upon demand, secured by the pledge and assignment, if necessary, of the stocks or bonds or any of them enumerated in subdivisions one, two, three, four, five and ten of this section or by the railroad bonds or any of them mentioned and described in subdivision seven of this section, but no such loan shall exceed ninety per centum of the cash market value of such securities so pledged. Should any of the securities so held in pledge depreciate in value after the making of such loan, the savings bank shall require an immediate payment of such loan or of a part thereof or additional security therefor, so that the amount loaned thereon shall at no time exceed ninety per centum of the market value of the securities so pledged for such loan.

(b) Promissory notes made payable to the order of the savings bank upon demand by a savings and loan association of this State which has been incorporated for three years or more and has an accumulated capital of at least fifty thousand dollars.

(c) Promissory notes made payable to the order of the savings bank within ninety days from the date thereof secured by the assignment and pledge to it of one or more first mortgages on real estate situated in the State of New York, provided that the amount of any such note is not in excess of sixty per centum of the appraised value in the case of improved real estate, or forty per centum in the case of unimproved or unproductive real estate, of the property or properties mortgaged; that the amount of any such loan shall not exceed seventy-five per centum of the principal sum secured by said mortgage or mortgages; that the value of said properties has been certified in accordance with the provisions of subdivision six of this section; that the assignment of each of such mortgages has been recorded in the proper offices and the provisions of Section two hundred and forty-one of this chapter with reference to the title of the property and the insurance upon the buildings, covered by such mortgage or mortgages, shall have been fully complied with. Such loans shall be considered mortgage loans and the amount thereof together with all direct loans by any such savings bank upon bonds and mortgages shall not exceed sixty-five per centum of the whole amount of the deposits and the guaranty fund of any such savings bank.

(d) Promissory notes made payable to the order of the savings bank within ninety days from the date thereof, secured by the pledge and assignment of the passbook of any savings bank in the State of New York as collateral security for the payment thereof. No such loan shall

exceed one hundred per centum of the balance due the holder of such passbook as shown therein.

9. Real estate as follows:

(a) A plot whereon there is or may be erected a building or buildings suitable for the convenient transaction of the business of the savings bank, from portions of which not required for its own use a revenue may be derived.

(b) Such as shall be conveyed to it in satisfaction of debts previously contracted in the course of its business.

(c) Such as it shall purchase at sales under judgment, decrees or mortgages held by it.

The trustees of a savings bank shall not be held liable for investing in State or municipal bonds named in the last list furnished by the superintendent of banks pursuant to Section fifty-two of Article two of this chapter, or in any railroad bonds mentioned in such list, which have been legally issued and properly executed, unless such savings bank shall have been notified by the superintendent of banks that, in his judgment, such bonds do not conform or have ceased to conform to the provisions of this section.

10. Bonds of the land bank of the State of New York.

10. (a) Farm loan bonds issued by the Federal land bank of the first land bank district as created pursuant to the Federal Farm Loan Act, approved July seventeenth, nineteen hundred and sixteen.

11. Bankers' acceptances and bills of exchange of the kind and maturities made eligible by law for purchase in the open market by Federal Reserve banks, provided the same are accepted by a bank, national banking association or trust company, incorporated under the laws of the State of New York or under the laws of the United States and having its principal place of business in the State of New York. Not more than twenty per centum of the assets of any savings bank less the amount of the available fund held pursuant to the provisions of Section two hundred and fifty-one of this chapter shall be invested in such acceptances. The aggregate amount of the liability of any bank, national banking association or trust company to any savings bank for acceptances held by such savings bank and deposits made with it shall not exceed twenty-five per centum of the paid-up capital and surplus of such bank, national banking association or trust company and not more than five per centum of the aggregate amount credited to the depositors of any savings bank shall be invested in the acceptances of or deposited with a bank, national banking association or trust company of which a trustee of such savings bank is a director.

§247. *Restrictions on Amount of Deposits; Refusal or Return of Deposits.*

1. The aggregate amount of deposits to the credit of any individual at any time, including in such aggregate all deposits credited to him as trustee or beneficiary of a voluntary and revocable trust and all deposits credited to him and another or others in either joint or several form, shall not exceed five thousand dollars, exclusive of dividends, and exclusive also of deposits arising from judicial sales or trust funds standing in his name as executor, administrator or trustee named in a will or appointed by a court of competent jurisdiction, provided a certified copy of the will, judgment, order or decree of the court authorizing such deposits or appointing such executor, administrator or trustee is filed with the savings bank; and exclusive, also, of trust funds and deposits credited to an individual and another or others in either joint or several form, received and credited by the savings bank prior to July first, nineteen hundred and thirteen. Additional accounts, may, however, be maintained in the name of a parent as trustee for a dependent or minor child and in the name of a child as trustee for a dependent parent, provided, however, that not more than two hundred and fifty dollars shall be deposited to any such account during any six months period.

2. The aggregate amount of deposits to the credit of any society or corporation at any time shall not exceed five thousand dollars, exclusive of dividends, unless such deposit has been made pursuant to a judgment, order or decree of a court of record and a certified copy of the judgment, order or decree is filed with the savings bank.

3. Every savings bank may further limit the aggregate amount which an individual or any corporation or society may deposit, to such sum as it may deem expedient to receive; and may, in its discretion, refuse to receive a deposit or at any time return all or any part of any deposit.

§252. *Guaranty Fund.*

The surplus of every savings bank, at the time this act takes effect, the contributions of its incorporators or trustees under the provisions of section two hundred and thirty-four of this article, and the sums credited thereto from its net earnings under the provisions of section two hundred and fifty-five of this article shall constitute a guaranty fund for the security of its depositors and shall be held to meet any contingency or loss in its business from depreciation of its securities or otherwise, and for no other purpose except as provided in section two hundred and thirty-six, two hundred and thirty-seven and subdivision six of section two hundred and fifty-six of this article.

§265. Compensation of Trustees, Officers and Attorneys.

1. A trustee of a savings bank shall not directly or indirectly receive any pay or emolument for his attendance at meetings of the board, or for any other services as trustee, except as provided in this section.

2. Trustees acting as officers of the savings bank, whose duties require and receive their regular and faithful attendance at the institution, and the trustees appointed as a committee to examine the vouchers and assets pursuant to section two hundred and seventy-two of this article, to perform the duties required by subdivision six of section two hundred and thirty-nine of this article, or to render other special services as members of committees provided for in the by-laws, may receive such compensation as in the opinion of a majority of the board of trustees shall be just and reasonable; but such majority shall be exclusive of any trustee to whom such compensation shall be voted.

3. An attorney for a savings bank, although he be a trustee thereof, may receive a reasonable compensation for his professional services, including examinations and certificates of title to real property on which mortgage loans are made by the savings bank; or if the savings bank requires the borrowers to pay all expenses of searches, examinations and certificates of title, including the drawing, perfecting and recording of papers, such attorney may collect of the borrower and retain for his own use the usual fees for such services, excepting any commissions as broker or on account of placing or accepting such mortgage loans.

4. If an officer or attorney of a savings bank shall receive, on any loan made by the savings bank, any commission which he is not authorized by this section to retain for his own use, he shall immediately pay the same over to the savings bank.

Rules and Regulations of a Savings Bank Respecting Deposits and Payments.

1. Every person desirous of becoming a depositor shall, at the time of making his or her first deposit, sign his or her name on a signature card, as prescribed by the Bank, and shall thereby signify his or her assent to the Rules and Regulations of the Bank and willingness to be bound thereby; and shall, in connection with the signature state his or her business, occupation or calling, and place of residence; and every such depositor will receive a book containing these Rules and Regulations, in which their names will be inscribed and the amount of their deposits inserted.

2. No money will be received from any depositor unless his or her book be presented, and an entry thereof be made by the proper officers

of the Bank, at the time of making the deposit; and no sum less than one dollar will be received as a deposit.

3. Deposits may be made by one person as trustee, for the benefit of another, or of any unincorporated society or association, at the discretion of the Treasurer. In all such cases the deposits shall be made in the name of the trustee, "in trust for" such person, society or association, and the trustee, or his successor, shall alone be entitled to receive payments, and his receipt with the production of the book, shall be a sufficient discharge. Provided, however, that in case of deposits for the benefit of another person, the corporation may, at their discretion, by a vote of the Board, make payment to such person on production of the book, which payment shall also be a sufficient discharge.

4. On deposits in this Bank, interest at a rate not exceeding Four per cent per annum will be allowed, but it will only be calculated on the deposits from the first days and fifteenth days of each month subsequent to each deposit. Interest will be made upon all deposits remaining in the institution half-yearly, to wit, on the first days of April and October, and will be paid to depositors on demand, on these days; but if not drawn, will go to their credit, and be compounding. No interest will be calculated in the fractional part of a dollar.

5. Deposits made in this bank can only be withdrawn on notice being given to the Treasurer, as follows:

If the sum proposed to be drawn be—

				Weeks' Notice	
More than \$	50	and not exceeding \$	100,	1	
"	100	"	"	200,	2
"	200	"	"	300,	3
"	300	"	"	400,	4
"	400	"	"	500,	5
"	500	"	"	600,	6
"	600	"	"	700,	7
"	700	"	"	800,	8
"	800	"	"	900,	9
"	900	"	"	1,000,	10
"	1,000	"	"	1,100,	11
"	1,100	"	"	1,200,	12
"	1,200	"	"	1,300,	13
"	1,300	"	"	1,400,	14
"	1,400	"	"	1,500,	15

Any sum over \$1,500, 4 months' notice.

All notices will be canceled if money is not drawn within ten days after expiration of notice.

If the amount be \$50, or under, no notice will be required, but an interval of one week must elapse before another withdrawal may be made.

If deposits be withdrawn prior to the regular interest days, viz.: First of April and first of October, no interest which might have accrued since the next preceding interest day will be allowed.

Not less than one dollar will be paid, unless to close an account. When money is to be drawn out, the book must be brought to the bank to have the payment entered therein, and in all cases in which the whole amount is drawn, the book must be given up to the corporation. Absent depositors may withdraw their deposits on their orders properly witnessed—blanks for which purpose will be furnished at the bank.

6. In case a book be lost, destroyed or obtained from a depositor fraudulently, immediate notice thereof must be given at the bank, and after two weeks from the time of such notice, with satisfactory evidence of the loss, and indemnity given (if required by the trustees), another book will be furnished. If any person shall present a book, and falsely allege himself or herself to be the depositor named therein, and thereby obtain the amount deposited, or any part thereof, this institution will not be liable to make good any loss the actual depositor may sustain thereby, unless previous notice of his or her book having been lost or taken shall have been given at the bank.

Suggested Readings on Chapter X.

Moulton, H. G.—Financial Organization, Chapter XVIII.

Kniffin, W. H.—The Savings Bank and Its Practical Work.

Hamilton, J. H.—Savings and Savings Institutions.

Willis, H. P., and Edwards, G. W.—Banking and Business, Chapter XX.

Kemmerer, E. W.—Postal Savings.

Questions and Problems on Chapter X.

1. Get statistics of savings banks by territorial distribution. Explain the distribution.
2. Argue for or against the mutual savings plan as compared with the stock savings plan.
3. What chances have the savings departments of commercial banks and trust companies of driving out the exclusive savings bank?
4. Why should any group of men wish to start a mutual savings bank?
5. Explain why, when 7 and 8 per cent could be obtained on safe investments, the savings banks could not increase the rate paid to depositors to at least 6 per cent.
6. What are the advantages and disadvantages of naming specific railroads whose bonds may be purchased for investment?
7. Which is the most efficient method of handling savings: through the savings bank, the investment banker, or the life insurance company? What is your test of efficiency?
8. Considerable agitation has arisen to permit savings banks to invest in bankers' acceptances. The New York law permits it. Discuss the proposal from the standpoint of safety, liquidity, return, and attention needed.
9. What would be the advantages and disadvantages of having all of the savings banks' funds invested in commercial paper?
10. Make a list of examples of each type of investment permitted by the New York State law, and of each type not permitted by law. Trace the course of prices of the various investments. Is the law wise?
11. Which of the regulations about investments of savings banks in New York can be justified as promoting safe investments and diversifying the risk? Are there any types of safe and desirable investments which the New York savings banks cannot use?
12. Can you suggest any influence started by war financing in the United States which may lessen the need for savings banks?
13. As an impartial reader, which of the rules of the savings bank seem to be fair and which unfair?

14. A savings account shows the following entries :

July 1, Balance	\$400
August 1, Deposit	200
September 1, Deposit	100
October 1, Deposit	100
November 1, Withdrawal	400

If the interest rate is 4 per cent, how much interest should be due January 1? Some banks would pay \$5.67. How can that amount be obtained? Is the practice fair?

15. Why should a bank be limited to 20 per cent in investing in acceptances?

16. Why should the law limit the amount that an individual may deposit in a savings bank?

17. Why is the bank granted the right to refuse deposits?

18. What would be the objection to paying trustees a moderate fee for each meeting attended?

19. Can efficient men be obtained to serve as trustees of savings banks when there is no remuneration? Is the analogy to the directors of a big corporation fair?

20. Compare the average size of the stock and the mutual savings banks.

21. Of the stock and the mutual savings banks, which have the higher percentage of real estate loans? What is the reason?

22. In which type of bank does the depositor have the greater amount of protection?

23. How do you explain the distribution of postal savings deposits among the different States?

24. Compare the total deposits in the postal savings system with those in the stock and mutual banks.

25. How can you justify the two-per-cent rate paid by the Government on postal savings?

26. Should the postal savings banks compete in rates with the other savings banks? Explain.

CHAPTER XI.

TRUST COMPANIES.

Causes for Growth of Trust Companies.

1. Great fortunes need care.
2. Big corporations and consolidations need financing and reorganizing.
3. The regulation of trust companies is often less strict than for other banks—in making loans and in the amount and the character of reserves (some can count bonds as reserves).
4. Taxation of trust companies is often less than that of other banks.
5. Trust companies attract deposits by paying interest on them.

Function of Trust Companies.

1. General.
 - a. Execution of corporate trusts: trustee for corporate mortgage, fiscal agent, registrar of stock, transfer agent, manager of underwriting syndicate. They also help reorganizations, and act as depositories for stock.
 - b. Execution of individual trusts: executor, administrator, trustee under will or contract, guardian, curator, assignee, receiver, custodian for property in dispute.
 - c. Care of securities and valuables.
 - d. Banking.
2. Special.
 - a. Life, title, and fidelity insurance; all except title insurance have become specialized.

Disadvantages of Trust Companies.

1. They fail from improper management.

2. The lack of personal management results in only a minimum return.
3. Individual trustees are often able men.

*Advantage of the Trust Company as Given by Kirkbride
and Sterrett.*

1. It does not die.
2. It does not go insane.
3. It does not leave the country.
4. It does not imperil the trust by failure or dishonesty.
5. It has better experience and judgment in trust matters.
6. It does not neglect the work or turn it over to untrustworthy people.
7. It does not refuse to act from caprice or on the ground of inexperience.
8. It can be consulted at all times.
9. It has no sympathies, antipathies or politics.
10. It will not resign.
11. It gets first chance at good securities and gets a good rate by buying in large quantities.

**Summary of Reports of Condition of 1,474 Loan and Trust Companies in the United States at the Close of Business,
June 30, 1921.**

From the Report of the Comptroller of the Currency for 1921, p. 140.

Loans and discounts:	
On demand (secured by collateral other than real estate).....	\$1,043,168,000
On demand (not secured by collateral).....	202,291,000
On time (secured by collateral other than real estate).....	660,897,000
On time (not secured by collateral).....	1,292,929,000
Secured by farm land.....	9,329,000
Secured by other real estate.....	478,591,000
Not classified.....	587,376,000
Total.....	\$4,274,581,000
Overdrafts.....	2,541,000
Investments (including premiums on bonds):	
United States Government securities.....	\$450,462,000
State, county, and municipal bonds.....	138,528,000
Railroad bonds.....	326,038,000
Bonds of other public-service corporations (including street and interurban railway bonds).....	203,020,000
Other bonds, stocks, warrants, etc.....	824,628,000
Total.....	1,942,676,000
Banking house (including furniture and fixtures).....	188,873,000
Other real estate owned.....	26,163,000
Due from banks.....	322,292,000
Lawful reserve with Federal Reserve Bank or other reserve agents.....	457,922,000
Checks and other cash items.....	47,148,000
Exchanges for clearing house.....	183,617,000
Cash on hand:	
Gold coin.....	\$9,698,000
Silver coin.....	5,562,000
Paper currency.....	95,172,000
Nickels and cents.....	37,350,000
Cash not classified.....	24,935,000
Total.....	172,717,000
Other resources.....	562,562,000
Total resources.....	8,181,092,000
LIABILITIES.	
Capital stock paid in.....	515,533,000
Surplus.....	537,947,000
Undivided profits (less expenses and taxes paid).....	111,614,000
Due to all banks.....	319,160,000
Individual deposits (including postal savings):	
Demand deposits—	
Individual deposits subject to check.....	\$3,636,542,000
Demand certificates of deposit.....	91,894,000
Certified checks and cashiers' checks.....	143,144,000
Dividends unpaid.....	10,277,000
Time deposits—	
Savings deposits, or deposits in interest or savings department.....	1,472,929,000
Time certificates of deposit.....	159,697,000
Postal savings deposits.....	24,105,000
Deposits not classified.....	216,343,000
Total.....	5,754,931,000
United States deposits (exclusive of postal savings).....	100,951,000
Notes and bills rediscounted.....	132,778,000
Bills payable (including certificates of deposit representing money borrowed).....	173,186,000
Other liabilities.....	534,992,000
Total liabilities.....	8,181,092,000

Materials on Chapter XI.

Advantages of the Trust Company.

A trust company is a corporation empowered to accept and execute all trusts recognized and permitted by law. It can be your guardian when you are under age; your agent or trustee when grown; your assignee or receiver; your faithful friend and adviser while you live, and your executor, administrator or testamentary trustee when you die. It can receive your securities or other property and give you a receipt therefor, collecting and forwarding you the interest thereon. It can be your general fiscal agent, to manage your property both real and personal; making leases, attending to repairs, etc.; and collecting interest and rents for you. It can invest the property which you may have accumulated for your family in the safest and most profitable manner, and when appointed executor it can store your will without cost to you in its fire- and burglar-proof vaults.

Some of the advantages of having a trust company act as executor are:

Ample security.—A trust company generally has a capital and surplus which forms a guarantee fund for the faithful custody and management of property intrusted to it. It is under the jurisdiction of the State Banking Department and a bank examiner is required by law to examine into its condition, conduct and affairs generally, under the direction of the State Banking Department. All information concerning estates which is gained by such examination is known only to the examiner. Thus the examinations afford additional security without publicity.

Its management is the combined wisdom of a number of able financiers and it has a reputation for skill and fidelity which it guards as jealously as it does its capital. That this is a safeguard is certain. You have but to watch the press reports to note the many instances where a trusted adviser, executor or trustee has been led into some speculation, neglect, or mistake of judgment, resulting in loss and leaving destitute and helpless a family accustomed probably to every luxury. This is one of the most serious dangers of having an individual manage an estate.

Ever present.—A trust company is always to be found when wanted and is always present to transact any business that may come up.

It is never out of town; never sick.

It cannot abscond and never takes a vacation.

Its life is perpetual; it cannot die.

Economy.—The trust company receives the same compensation or commission as an individual, but is usually able to handle an estate more

economically. The commission amounts to very little on each estate, yet by caring for a large number of estates, the company brings to the management of each, men of greater ability and experience than that of any individual who could be induced to act.

Therefore, when turned over to a company an estate receives the benefit of the judgment and experience of a number of men, instead of an individual.

Further, the cost of a bond from a surety company for an individual is an additional charge on the estate, not necessary when a company acts for you.

Then, suppose the individual, executor or trustee, should die before the trust has been completed. His successor is entitled to another commission.

The trust company has its own burglar-proof and fire-proof vaults in which to store the securities of an estate, thus making them more secure than if stored at home by an individual, or saving the expense of keeping them with a safe deposit company.

Income.—By reason of the fact that the trust company is managed by able and experienced financiers it is able to secure for estates more profitable investments, consistent with safety, than an individual could ordinarily secure.

The company usually can assign to an estate an interest in a large mortgage of excellent security the day the money is received because its large capital and surplus enables it to buy good mortgages when offered. These are transferred to trust estates the moment the funds are available and the company's money is again left free to take up other desirable mortgages. In this way trust funds are kept from being idle until separate investments of the exact amount on hand can be secured for each. The individual executor is not able to keep funds thus constantly employed.

Likewise the trust company can usually secure a larger revenue from real estate, and can dispose of it when desired on better terms than can the individual executor or trustee, because of the ability and experience of the men who transact this kind of business for it.

Exactness.—The accounting and auditing is another feature in which the trust company excels the individual. It has special forms and books prepared with much care, in which are recorded all transactions in connection with the estates it manages. By its methods nothing can escape attention.

Its systems show when rents are due, when interest should be collected, when insurance should be renewed, when leases expire, when taxes are due, etc.; all of which an individual cannot look after as

promptly and accurately because lack of method often permits them to escape his attention.

As executor.—As executor, appointment being by will, a company is responsible for the care and keeping of the estate until the time fixed by law for its final disposition as provided in the will.

As trustee.—As trustee under a will, the company is given the custody of the property to hold and manage until such time as may be designated. This may be until children become of age, or it may be for the purpose of securing the beneficiary an income for life, or any other purpose allowed by law.

As administrator.—As administrator, the appointment is made by the Register of Wills and the duties are primarily the same as those of executor.

As guardian.—As guardian, the appointment may be made by will or by Court. The duties involve the care and management of the minors' estates until they become of age; to manage the estates of mentally incompetent persons and to provide for their care and treatment; etc.

As receiver.—Appointed receiver, the company takes charge of and cares for property pending litigation affecting the final disposition thereof. The appointment is frequently made on application of creditors who deem the debtor insolvent. A receiver is governed by the order of the Court and may be empowered to carry on business until the final disposition of the property.

As agent.—The trust company acts as agent for those who for any reason wish to transfer the management of their property to it, collecting rents, interest, mortgages, dividends, coupons, bonds, accounts, and all kinds of incomes or securities. It pays taxes, allowances, insurance, and other expenses, buys, sells and rents property to which it gives general care and attention.

As trustee of bonds.—Large corporations often wish to convert their current obligations into time debts, so that they will not be embarrassed by sudden calls for funds. Or it may become necessary to issue bonds for construction and working capital, secured by mortgage. All trust deeds securing interest-bearing bonds should have a corporate trustee. The company offers its service as Trustee of the bonds of corporations, and guarantees efficient, unprejudiced and impartial service.

As registrar.—Acting as registrar, the company becomes responsible for the issue of the stock of other corporations. The advantage of having a responsible company attend to this will be apparent. It prevents the fraudulent issue of stock. It makes officials more careful. It saves individual investigation, and overissue of stock is made impossible.

Practical reasons.—We mention here a few of the many practical reasons why a trust company is to be preferred to an individual as executor or trustee of estates.

If a friend or relative of the testator is appointed, he may die, refuse to accept the trust or resign and the Court may appoint as his successor some one whom the testator would not have desired.

A company lives forever. It never refuses to act and retains possession of the estate until the trust has been completed.

An individual usually has business interests of his own that demand his best attentions; and if appointed executor or trustee is apt to turn over much of the work to less competent employees.

The trust company has employees especially trained in such work who do not slight it in any way, but give it their best attention under the personal direction and supervision of the officers.

An individual may be taken sick, may travel or be away at critical times. He may not give those interested any definite information as to the condition of the estate, and a suit for an accounting may thus become necessary. In case a friend of the family is acting, it is often embarrassing to insist upon a statement.

A company always attends to business promptly; its offices are always open during business hours; its accounts are kept accurately and may be readily referred to. Anyone having the right to examine the books can do so at any time.

When the widow of the testator is made executrix it often happens that she has not the business training necessary safely and judiciously to settle the estate and she must depend upon a friend or agent to take the burden of responsibility. Usually she does not wish the position. If a member of the family is appointed there is often the possibility of ill feeling resulting.

A company never delegates its work to untried or inefficient clerks. It always has the benefit of experienced officers and employees and is absolutely impartial in its management of estates.

When two executors or trustees are appointed differences of opinion as to the management of an estate may involve law suits and an endless amount of trouble. In some cases one may have to suffer heavy loss in damages on joint bond for the fraudulent acts of the other.

Any question of policy can at once be referred to the board of directors of the trust company, thus securing the advice and counsel of a number of experienced men and avoiding rash mistakes, while the company is financially responsible for their acts.

An individual may through unwise investments cause a heavy loss to an estate, yet will rarely be held liable by Court if the investments

are of the class recognized as legal for trust funds, because he is bound to use only his best judgment.

The investment of estate funds is made by a company only upon the approval of the executive committee, consisting of officers and directors experienced in judging the value of securities.

The entire resources of the company are liable for the faithful performance of trusts administered by it. It naturally therefore takes every precaution to prevent loss.

It has no inducements to speculate, because its interests are all the other way. It expects to continue in business permanently and must have the confidence of the people.

All trust securities belonging to estates are kept separate and distinct from the securities of the company, and no trust funds are ever placed in any but the safest and most conservative investments.

When requested to draw up a will and act as executor of an estate, a company prefers to retain the testator's legal counsel in every instance.

Safe deposit.—A trust company generally rents boxes in its vaults. The vaults are fire- and burglar-proof and are protected by the best known safety devices. Massive steel doors protected by time locks and electricity guard the entrance. Box renters are accorded free use of coupon rooms, where securities may be examined and other private business transacted, as well as the free use of a room for committee or board meetings.

The company may also have large storage vaults in which it rents space for the safe keeping of valuables too large for a safe deposit box, such as silverware, etc. The charges are moderate and the security absolute.

Selections from New York Laws Governing Trust Companies.

§185. *General Powers.*

In addition to the powers conferred by the general and stock corporation laws, every trust company shall, subject to the restrictions and limitations contained in this article, have the following powers:

1. To act as the fiscal or transfer agent of the United States, of any State, municipality, body politic or corporation; and in such capacity to receive and disburse money, to transfer, register and countersign certificates of stock, bonds or other evidences of indebtedness, and to act as attorney in fact or agent of any person or corporation, foreign or domestic, for any lawful purpose.

2. To discount and negotiate promissory notes, drafts, bills of exchange and other evidences of debt; buy and sell exchange, coin and

bullion; lend money on real or personal securities; and to receive deposits of moneys, securities or other personal property from any person or corporation upon such terms as the company shall prescribe.

3. To lease, hold, purchase and convey any and all real property necessary in the transaction of its business, or which the purposes of the corporation may require, or which it shall anywhere acquire in settlement or partial settlement of debts due the corporation by any of its debtors, or to secure such debts, or through sales under any judgment, decree or mortgage held by it.

4. To act as trustee under any mortgage or bonds issued by any municipality, body politic or corporation, foreign or domestic, and accept and execute any other municipal or corporate trust not prohibited by the laws of this State.

5. To accept trusts from and execute trusts for married women, in respect to their separate property, and to be their agent in the management of such property or to transact any business in relation thereto.

6. To act under the order or appointment of any court of competent jurisdiction as guardian, receiver or trustee of the estate of any minor, and as depository of any moneys paid into court, whether for the benefit of any such minor or other person, corporation or party, and in any other fiduciary capacity.

To be appointed and to act under the order or appointment of any court of competent jurisdiction as trustee, guardian, receiver or committee of the estate of a lunatic, idiot, person of unsound mind or habitual drunkard, or as receiver or committee of the property or estate of any person in insolvency or bankruptcy proceedings; to be appointed and to accept the appointment of executor of or trustee under the last will and testament, or administrator with or without the will annexed of the estate of any deceased person.

7. To take, accept and execute any and all such legal trusts, duties and powers in regard to the holding, management and disposition of any estate, real or personal, wherever located, and the rents and profits thereof, or the sale thereof, as may be granted or confided to it by any court of competent jurisdiction, or by any person, corporation, municipality or other authority and it shall be accountable to all parties in interest for the faithful discharge of every trust, duty or power which it may so accept.

8. To take, accept and execute any and all such trusts and powers of whatever nature or description as may be conferred upon or intrusted or committed to it by any person or persons, or any body politic, corporation, domestic or foreign, or other authority by grant, assignment,

transfer, devise, bequest or otherwise, or which may be intrusted or committed or transferred to it or vested in it by order of any court of competent jurisdiction, or any surrogate, and to receive, take, manage, hold and dispose of according to the terms of such trust or power any property or estate, real or personal, which may be the subject of any such trust or power.

9. To purchase, invest in and sell stocks, bills of exchange, bonds and mortgages and other securities; and when moneys or securities for moneys are borrowed or received on deposit, or for investment, the bonds or obligations of the company may be given therefor but it shall have no right to issue bills to circulate as money.

10. To accept for payment at a future date, drafts drawn upon it by its customers and to issue letters of credit authorizing the holders thereof to draw drafts upon it or its correspondents at sight or on time, not exceeding one year.

11. To receive, upon terms and conditions to be prescribed by the company, upon deposit for safe keeping, bonds, mortgages, jewelry, plate, stocks, securities and valuable papers of any kind, and other personal property, for hire, and to let out receptacles for safe deposit of personal property.

12. To purchase and hold, for the purpose of becoming a member of a federal reserve bank, so much of the capital stock thereof as will qualify it for membership in such reserve bank, pursuant to an act of Congress, approved December twenty-three, nineteen hundred and thirteen, entitled the "Federal Reserve Act"; to become a member of such federal reserve bank, and to have and exercise all powers, not in conflict with the laws of this State, which are conferred upon any such member by the federal reserve act. Such trust company and its directors, officers, and stockholders shall continue to be subject, however, to all liabilities and duties imposed upon them by any law of this State and to all the provisions of this chapter relating to trust companies.

§197. *Reserves Against Deposits.*

Every trust company shall maintain total reserves against aggregate demand deposits, as follows:

1. Fifteen per centum of such deposits if such trust company has an office in a borough having a population of two millions or over; and at least ten per centum of such deposits shall be maintained as reserves on hand.

2. Thirteen per centum of such deposits, if such trust company is located in a borough having a population of one million or over and less than two millions, and has not an office in a borough specified in

subdivision one of this section; and at least eight per centum of such deposits shall be maintained as reserves on hand.

3. Ten per centum of such deposits, if such trust company is located elsewhere in the State. Trust companies located in cities of the first and second class but not falling within subdivisions one or two of this section, shall maintain at least four per centum of such deposits as reserves on hand; and trust companies located in cities of the third class and in incorporated and unincorporated villages, shall maintain at least three per centum of such deposits as reserves on hand.

Any part of the reserves on hand in excess of three per centum of such deposits may be deposited, subject to call, with a federal reserve bank in the district in which such trust company is located and the reserves on hand not so deposited shall consist of gold, gold bullion, gold coin, United States gold certificates, United States notes or any form of currency authorized by the laws of the United States; but if any trust company shall have become a member of a federal reserve bank, it shall maintain such reserves with such federal reserve bank as are required by the federal reserve act and so long as it complies with the requirements of such federal reserve act with reference to reserves shall be exempt from the preceding provisions of this section.

If any trust company shall fail to maintain its total reserves in the manner authorized by this section, it shall be liable to, and shall pay the assessment or assessments provided for in section thirty of this chapter.

Suggested Readings on Chapter XI.

- Kirkbride, F. B., Sterrett, J. E., and Willis, H. P.—*The Modern Trust Company.*
- Herrick, C.—*Trust Companies, their Organization, Growth, and Management.*
- U. S. Mortgage and Trust Co.—*Trust Companies of the United States.*
- Perine, E. T.—*The Story of the Trust Company.*
- Barnett, G. E.—*Growth of State Banks and Trust Companies since 1865.*

Questions and Problems on Chapter XI.

1. In most States, trust companies are not required to keep as high a percentage of reserves as commercial banks. Does this fact help or hinder them in their competition with commercial banks?

2. Compare the combined statements of the trust companies of the United States with the combined statements of the national banks with reference to (1) character of investments; (2) proportion of reserves; and (3) character of deposits.

3. With reference to the list of advantages of the trust company over the individual trustee, how many are really true of the average trust company? In each statement, consider whether there is any disadvantage connected with the way in which the trust company acts.

4. If you had an income of \$1,000,000 a year, how might you use a trust company in taking care of your fortune? Assume that your fortune includes most forms of wealth. Tell the specific things the trust company could do in connection with each form of wealth.

5. The Federal Reserve Act permits certain national banks to have trust departments. What advantages might such a trust department have over an ordinary trust company? What disadvantages?

6. Some trust companies carry on extensive investment banking operations. How do such transactions show on their balance sheet?

7. Outline the organization of a trust company. If all of the departments are to be in charge of specialists, estimate the number of high-salaried men they would need. Estimate the amount of trust business necessary to pay expenses if fees average $\frac{1}{2}$ of 1 per cent of the value of the property held. Estimate the population necessary to support the trust company.

CHAPTER XII.
GOVERNMENT REGULATION OF BANKING IN
THE UNITED STATES TO 1860.

1. Basis.

The banks furnish part of the medium of exchange. Our present economic organization, based on complex division of labor, will not function properly unless exchanges can be conducted smoothly. Hence the government must take some interest in the way banks are conducted.

2. Extent.

The government may:

- a. Own part of the stock.
- b. Control operations.
- c. Exercise no regulation.

Why Study Banking History?

Our present banking system is the outgrowth of an evolution and can best be understood by tracing the experiments in banking practice and legislation which are responsible for it. We ought not make, a second time, the mistakes of earlier days.

Problems of Bank Regulation.

1. Charters.

The problem early arose as to whether, in addition to private banks, corporate bodies with limited liability should be chartered to carry on the banking business. Private bankers are of two sorts:

- a. Big-investment bankers, who promote and finance enterprises, sell securities, act as fiscal agents for corporations and government bodies, and sometimes deal in commercial paper.
- b. Small bankers, who often combine banking with other business, such as real estate operations. They seek deposits among the poor, especially immigrants. In places where no organized bank exists, the storekeeper often acts as a banker. There are, however, objections to private banks.

The assets and liabilities are part of the private estate of the banker, and if he dies, his estate goes to the probate court, and the depositors are in the same position as the other creditors. The outside activities of the banker may make the bank insolvent, and if the private banker goes insane, his estate will be tied up.

At first, each bank was chartered by a special act of the legislature. This resulted in many evils. Charters would not be granted to men who belonged to the party out of power, and much of what we now call graft arose particularly in the distribution of the stock.

2. Note issues.

The government early regulated note issues, because they entered so largely into circulation. The first question, naturally, is whether the banks or the government should issue the notes. Bank notes are alleged to be superior to government notes because:

- a.* The security is tangible. The bank has loans to back its notes, whereas the government gets no assets for most of its expenditures. Furthermore, the bank has its capital and surplus as a guaranty fund, but citizens cannot sue the government if it does not pay.
- b.* Reckless issues by the government may imperil the monetary standard.
- c.* The government cannot gauge the amount of notes needed as accurately as can the banks.
- d.* The government is unwilling to keep the necessary reserves.
- e.* There is a temptation for the government to meet expenses by inflating the currency.

Government notes are alleged to be superior to bank notes because:

- a.* The furnishing of the medium of exchange is a governmental function.
- b.* Banks may bring on panics by overissue.
- c.* In the past, many banks issuing notes have failed.
- d.* Government issues insure safety and uniformity.
- e.* There is a chance for private manipulation and private profit in bank notes.

- f. The government receives the free use of a sum of money equal to the notes outstanding, less the reserve held.

Methods of securing ultimate and immediate redemption of bank notes have been tried:

- a. Reserve requirements.
- b. Provision for a guaranty fund.
- c. Deposit of specific security (bonds).
- d. Basing the bank notes on the general assets of the bank.
- e. Giving notes a prior lien on the assets of the bank.
- f. Issuing notes with the government guaranty.

3. Capital.

The great trouble at first was to get the capital actually paid in cash. Often the stockholders borrowed from the bank the money with which to pay for their stock. The laws prescribe the minimum capital. They aim to require an amount of capital adequate for the volume and character of the business. The criterion usually used is population. It is to be noted that a high minimum may result in large-scale banking. If branches are permitted, small places can get accommodations.

4. Reserves.

Reserve requirements are necessary because competition tends to keep reserves down, the bank with the smallest reserve making the largest profits. Irrespective of legal requirements, the amount of reserves will vary with:

- a. The season of the year.
- b. The character of the accounts. More is needed if the bank has a few large depositors.
- c. The activity of the accounts. More is needed with active accounts, such as those of stock brokers.
- d. The amount of money being sent out of the community.
- e. The business habits of the bank's customers.
- f. The stage of the business cycle. The bank needs a larger amount of reserves in stringent times.

Historical Examples.

1. The First and Second United States Banks, 1791-1811, 1816-1836.

These were large banks with branches throughout the country. The Government owned one-fifth of the capital stock

in each case. They acted as fiscal agents for the Government, helping in the collection and disbursement of revenue, the handling of Government loans, and they themselves loaning to the Government. With their branches, they conducted the domestic exchange of the country. Their notes, based on the general assets of the bank, provided a safe and uniform currency. Jealousy of the State banks and politics were responsible for the failure to recharter. There are certain lessons to be derived from the experiences of the First and Second United States Banks:

- a.* The Government funds are best handled by a central bank.
- b.* Politics ought not to enter into bank management.
- c.* Notes based on general assets may be safe.

2. The Suffolk System, 1824.

This was a system by which the New England banks redeemed their notes in Boston. Practically, the Suffolk was a clearing house for the notes. Each bank kept a balance with the Suffolk Bank to meet the notes presented. The system is the analogue of our par-check collection system, run by the Federal reserve banks. From the experiences of the Suffolk Bank we gather that:

- a.* Immediate redemption, as well as ultimate redemption, is needed to maintain notes at par.
- b.* Loans were based on note liability; consequently, quick and easy redemption tested the quality of the loans and assets.
- c.* Redemption at business centers is essential.

3. The New York Safety Fund, 1829.

A group of special charter banks contributed to a fund to pay obligations of failed banks; at first, both in the form of deposits and notes; later just the notes. This system is of interest because of its bearing on the guaranty of bank deposits. An examination of its operation shows that:

- a.* Contributions to the fund should have been levied on circulation; not on capital.
- b.* The fund was insufficient for both deposits and notes.
- c.* Specific security gives an inelastic currency.

4. The New York Free Banking Law, 1838.

This law permits people to start a bank without getting a

special charter from the legislature. The notes were obtained by depositing securities with a State official. The plan was followed by the national banking system. The experience under this law shows that:

- a.* Ultimate redemption depends on the character of securities.
- b.* If immediate redemption is not cared for, notes will depreciate.
- c.* Specific security gives an inelastic currency.

5. The Indiana State Bank, 1834.

The State provided part of the capital. The State bank was really a board of control for the branches. It was the prototype of the present Federal Reserve Board. As the result of experience, loans on real estate were barred. The bank was extremely successful because:

- a.* Loans on real estate were rejected.
- b.* Separate banks were unified by supervision.

6. Provisions of the Louisiana Bank Act of 1842.

The act provided that the bank must maintain a reserve of one-third of all liabilities to the public. The other two-thirds had to be covered by commercial paper with a maturity of not more than 90 days. The names of borrowers who did not pay their paper at maturity or asked extensions were given to other banks. All banks were examined by a State officer quarterly or oftener, and the bank directors were individually liable for all loans and investments made in violation of the law. It was further stipulated that each bank must have not less than 50 shareholders, holding 30 shares each. Furthermore, directors going out of the State for more than 30 days or missing five meetings were considered to have resigned. No bank was allowed to pay out any notes except its own, balances between banks had to be paid each Saturday in specie or the bank would go into liquidation, and no bank could purchase its own shares or loan more than 30 per cent of their market value on them. The Louisiana Bank Act of 1842 is significant because it stresses these two points:

- a.* The safety of the bank depends on the character of the assets.
- b.* A bank with demand obligations should keep its assets liquid.

Materials on Chapter XII.

The First United States Bank, by L. Carroll Root.¹

Adapted from Sound Currency, Vol. IV, No. 7, pp. 2-12.

Introductory.

DEVELOPMENT OF BANKING PRIOR TO 1791.

Prior to the establishment of the Bank of the United States, in 1791, the progress of banking in this country had not been great. Several of the colonies had ventured a little way into the field; but the extent to which they were drawn off from the exercise of banking functions into the realm of fiat money was not at all encouraging. Nevertheless there had been several experiments and considerable advance from the crude conceptions of banking which had characterized the earlier ventures.

Private banking started practically, so far at least as currency was concerned, with an issue of notes to the amount of £110,000 by an unincorporated association of Boston merchants in 1733. This was followed by the "Land Bank" and the "Specie Bank," also in Massachusetts, in 1740. In respect to all of these the notes, though not payable until ten, fifteen or twenty years after date, and then sometimes only in commodities, were regarded as superior to the issues of the Colonies. All progress was, however, arrested soon after 1740 by the extension, to cover the colonies, of the "Anti-Bubble" Act of Parliament prohibiting the formation of banking companies without special charters.

During the next forty years the financiers of the country had more than enough to do to keep track of the multitude of colonial emissions of paper currency, and the many and constantly varying scales of depreciation to which it was subject. Consequently it is hardly surprising that banking did not flourish.

In 1780 another move was made in the establishment of the Bank of Pennsylvania. This, however, was little more than a means of procuring for the army the supplies of which it was then in great need—the subscribers furnishing the funds with which to purchase three million rations and three hundred hogsheads of rum, and accepting therefor the interest-bearing notes of the bank, while a resolution of Congress

¹ For the leading authorities on the Bank of the United States, the reader is referred to—Clark (M. St. Clair) and Hall (D. A.)—*Legislative and Documentary History of the Bank of the United States, Including the Original Bank of North America.* Washington, 1832.

White (Horace)—*Money and Banking*, pp. 256-313.

Conant (Chas. A.)—*History of Modern Banks of Issue*, pp. 286-309.

Sumner (W. G.)—"History of Banking in the United States" (Vol. I of *History of Banking in all Nations*), pp. 22-57.

Knox (John J.)—"History of Banking in the United States," in *Rhodes' Journal of Banking*, May, 1892, Vol. XIX, pp. 485-520.

Holles (A. S.)—*Financial History of the United States*, Vol. II, pp. 127-155.

to reimburse fully the bank for the advance gave some promise of a return to the stockholders of their subscriptions. By 1784 these advances were in fact repaid and the bank was wound up.

Other proposals for the formation of banks had been made by Robert Morris as early as 1763, and by Alexander Hamilton in 1779. Nothing appears to have come from the former. Hamilton's interest, however, changed in its direction, led to the establishment of the Bank of New York in 1784.

THE BANK OF NORTH AMERICA.

In 1781 Robert Morris, shortly before he became Superintendent of Finance, presented to Congress a plan for the establishment of the Bank of North America, with a capital of 1,000 shares of \$400 each (\$400,000), to be increased if desired. Congress approved the plan on May 26, 1781, and on December 31st granted a perpetual charter, recommending that the several States should ratify it and provide by legislation against the establishment of additional banks. In January following the bank began business—having absorbed into itself whatever elements of strength the Bank of Pennsylvania possessed.

Morris, as Superintendent of Finance, subscribed for about \$250,000 of stock, paying for it with silver obtained from France. The necessities of the Government, however, were so urgent that by July, 1782, he had borrowed \$400,000 from the bank, and on being pressed for repayment in December, sold the most of the stock in his hands and with the proceeds reduced the Government's indebtedness to the bank. In July, 1783, the last of the Government's stock was sold in Holland.

The States of Pennsylvania, New York, Rhode Island, Connecticut, Massachusetts and Delaware, acting on the recommendations of Congress, recognized the bank and encouraged it by granting to it a temporary monopoly of the field. Pennsylvania, indeed, granted it a perpetual charter in 1782, but in 1785 repealed it and left the bank to operate under its charter from Congress, or some of the other States, until in 1787 it was once more rechartered by Pennsylvania for a period of fourteen years.

The bank was of great assistance to the Government in the closing years of the war and in the subsequent years of liquidation of indebtedness. At first its notes were not received with much favor; but in three or four years the bank occupied a strong position and its notes were current throughout the country at par, notwithstanding the great mass of depreciated Continental money under the load of which the country was still struggling. Hamilton, then Secretary of the Treasury, in a letter dated September 22, 1789, directed the Collector of Customs of

Baltimore to receive as equivalent to specie in payment of duties the notes of the Bank of North America, and of the Bank of New York payable on demand, or at no longer period than 30 days.

THE BANK OF NEW YORK.

The Bank of New York was organized in 1784 when the only other bank in the country was the Bank of North America. It operated under articles of association drafted by Alexander Hamilton.

Application for a charter had been made to the Legislature earlier in the year, but failing to secure it, the subscribers determined to wait no longer for legislation. Accordingly, on the 9th of June, 1784, the subscriptions having been paid in and some deposits secured, the bank formally commenced business. For seven years it issued its notes and carried on a banking business without a charter—the stockholders, in the absence of legislative action, being liable without limit for the debts of the bank, and being left as free to carry on business as the individual members of the association would have been.

The rate of discount established by the bank was 6 per cent and the directors determined that no discount should be made for longer than thirty days, nor would any note or bill be discontinued to pay a former one. The transactions of the bank in its early years were carried on partly expressed in "dollars" and partly in pounds, shillings and pence (*New York Currency*).

HAMILTON'S REPORT.

Alexander Hamilton's earlier views on banking were not such as to do him much credit. In 1779 he had written to Morris favoring a bank of issue based on landed security. By 1784, however, when the Bank of New York was established under Hamilton's guidance, he appears to have rid himself of this erroneous idea; for that bank, started as a matter of fact to thwart the establishment of a land bank, was based on the sound principle that quick assets constitute the safest basis for a bank currency or for general banking operations.

This view influenced Hamilton in his recommendations for a national bank made in his report to Congress in 1790. The subject of banking was then so little understood that Hamilton felt it necessary to devote a large part of this report to an explanation of the functions of a bank and a refutation of certain popular misconceptions. And while there are a few points as to which his treatment cannot be commended, the report as a whole was unquestionably of value in stimulating better thought and discussion of the subject. One of the things which he perceived and clearly expressed was the function of bank deposits. He said: "Every

loan which a bank makes is, in its first shape, a credit given to the borrower on its books, the amount of which it stands ready to pay, either in its own notes, or in gold, or silver, at his option. But in a great number of cases, no actual payment is made in either. The borrower, frequently, by a check or order, transfers his credit to some other person to whom he has a payment to make; who, in his turn, is as often content with a similar credit, because he is satisfied that he can, whenever he pleases, either convert it into cash or pass it to some other hand as an equivalent for it. And in this manner the credit keeps circulating, performing in every stage the office of money, till it is extinguished by a discount with some person who has a payment to make to the bank, to an equal or greater amount. Thus large sums are lent and paid, frequently through a variety of hands, without the intervention of a single piece of coin."

Hamilton also took occasion in this report to express his disapproval of issues of Government notes, as follows:

"The emitting of paper money by the authority of Government is wisely prohibited to the individual States by the National Constitution; and the spirit of that prohibition ought not to be disregarded by the Government of the United States. Though paper emissions, under a general authority, might have some advantages not applicable, and be free from some disadvantages which are applicable to the like emissions from the State separately, yet they are of a nature so liable to abuse, and, it may even be affirmed, so certain of being abused, that the wisdom of the Government will be shown in never trusting itself with the use of so seducing and dangerous an expedient."

After stating the consideration which led him to favor a Federal bank he considered the position of the Bank of North America, and while giving it credit for its services to the Government, expressed himself as favoring a new bank—feeling that the Bank of North America had injured its usefulness as a national bank by accepting a charter from the State of Pennsylvania, limited as it was under that charter, both as to the duration of its corporate life and the amount of its capital. He therefore set out in detail his suggestions for the incorporation of a bank of the United States.

The Bank Established.

THE CHARTER SECURED.

Congress passed the act granting a charter to the Bank of the United States practically as proposed by Hamilton. This was not done, however, without strong opposition in Congress and elsewhere—based in part upon a denial of the utility of banks or upon special provisions in the pending bill, but mainly upon the unconstitutionality of such an act.

Their argument was that since there was in the Constitution no express grant of such a power to Congress, it must be considered as having been reserved to the States or to the people. In general the opposition came from the Republicans (as the present Democratic Party was then named).

In the House of Representatives the vote was 39 in favor to 19 against the measure. The nineteen who voted against the measure (including among their number James Madison) were, with one exception, from the States of Maryland, Virginia and North and South Carolina; while all but four of the 39 advocates were representatives of the Northern States. Before signing the bill Washington called for the opinions of the members of his Cabinet. Edmund Randolph, Attorney-General, and Thomas Jefferson, Secretary of State, argued adversely to the power of Congress to charter a national bank.

Hamilton, Secretary of the Treasury, and Knox, Secretary of War, favored it—the former in a carefully prepared argument on the question of constitutionality supplementing his earlier report.

Washington signed the act, which thus became a law on February 25, 1791.

CONDITIONS OF THE CHARTER.

1. **Capital.**—The capital was fixed at \$10,000,000, divided into 25,000 shares of \$400 each. One-fifth, \$2,000,000, was to be subscribed by the Government on the terms noted below. The remaining \$8,000,000 was open to subscription by the public, one-fourth to be paid in specie and three-fourths in Government obligations bearing 6 per cent interest.

2. **Administration.**—The protection of the small investors in the stock was secured by a graduated scale of voting which allowed each shareholder to cast one vote for one share, one additional vote for every additional two shares up to ten, another for every three shares, etc., no one being allowed to cast more than 30 votes. Foreign stockholders were not allowed to vote by proxy. The management was intrusted to a board of 25 directors—to serve without compensation—all of whom must be citizens of the United States. Not more than three-fourths were to be eligible for re-election—a provision urged by Hamilton in the belief that the rotation in office thus assured would be conducive to better and safer management.

3. **The Government's interest.**—The President was authorized to subscribe for \$2,000,000 of the stock. This, however, was to be, as Hamilton described the operation, merely "borrowing with one hand what is lent with the other"; as it was further provided that the money

with which to pay for the stock was to be borrowed from the bank, payable in ten annual installments of \$200,000 each, or sooner if the Government should think fit. No other loans exceeding \$100,000 were to be made to the Government without authority of law.

4. **Note issue.**—As in other banks chartered about this time, no express authority to issue notes to circulate as currency was conferred, as it was assumed that such a right existed unless especially prohibited. The issue of notes is several times referred to, however. It is provided, for example, that they shall be binding though not under seal; they are mentioned among the liabilities to be reported by the bank, and there is the provision “that the bills or notes of the said corporation originally made payable, or which shall have become payable, on demand, in gold or silver coin, shall be receivable in all payments to the United States.”

There was, however, a limit upon note issues in the section which limited all debts other than deposits to the amount of the capital stock, \$10,000,000. In case of issues of notes in excess of this the directors were to be personally liable to creditors of the bank; but such of the directors as may have been absent or dissenting from the action might exonerate themselves by prompt notice of the fact of their absence or dissent to the President of the United States and to the stockholders, at a meeting called for that purpose.

5. **Branches.**—The directors were given authority to establish branches wherever, within the United States, they might deem proper.

6. **Reports.**—The bank was required to furnish the Secretary of the Treasury as often as he should require, not exceeding once a week, a detailed statement of its financial condition, and the Secretary was given the right to inspect such general accounts on the books of the bank as referred to such statements.

7. **Other limitations.**—The bank was not forbidden to loan on real estate security, but could not hold real estate, beyond that necessary for its banking houses, unless it came into its hands in satisfaction of mortgage or judgments.

The Government was pledged to grant no other bank charter during the continuance of this one, which was to run for twenty years.

The Bank in Operation.

In two hours after the opening of the books the capital was oversubscribed to the amount of four thousand shares, and the corporation started off as a financial success. Oliver Wolcott, afterward Secretary of the Treasury, was offered the presidency, but declined, and Thomas Willing, of Philadelphia, was selected.

The central bank was stationed at Philadelphia, beside the seat of

Government, and \$4,700,000 of the capital was reserved for that office. The remainder was distributed among the branches—of which eight were eventually established—at New York, Boston, Baltimore, Washington, Norfolk, Charleston, Savannah and New Orleans.

RELATIONS TO THE FEDERAL GOVERNMENT.

The practical effect of the Government holdings of stock was simply to give the bank the note of the Government for its final payment, but as the bank was forbidden to deal in its own stock, the process of issue of the Government stock was somewhat complicated. It would have been useless for the Government to draw money from Europe to pay into the treasury of the bank, to be immediately drawn out again and remitted to Europe for charges there. The course adopted was for the Treasurer of the United States to draw bills of exchange on the American Commissioners in Amsterdam for the amount required to pay the bank. The bills were purchased by the bank and warrants issued in favor of the Treasury upon the bank, thereby placing the amount in the Treasury. Other warrants were then issued upon the Treasury in favor of the bank for the amount of the subscription to the stock, which the bank receipted for as paid. The stock having been thus paid for in accordance with law, the bank loaned \$2,000,000 to the Government in accordance with the act of incorporation by handing over the bills of exchange originally drawn by the Treasury on Amsterdam.¹

The bank made several loans to the Government in anticipation of the revenues early in its career. They were not promptly paid, and the debt of the Government to the bank at the end of 1792 was \$2,556,595, which increased at the end of 1795 to \$6,200,000. An attempt was made to sell Government 5 per cent stock, but only \$120,000 was realized, and it became necessary for the Government to part with one of its most valuable assets—its shares in the bank. The third and fourth installments of the original \$2,000,000 loan to the Government were not paid until 1797, when 2,160 shares of the Government stock were sold at \$500 per share (a premium of \$100) and the proceeds, \$1,080,000, were applied to these two installments and to other obligations of the Government to the bank. Six hundred and twenty more shares were sold soon afterward for \$304,260, and in 1802 the remaining shares were sold at an advance of 45 per cent, and the Government ceased to be a stockholder. Secretary Gallatin reported in 1809 that the Government made a profit of \$671,860 on the sale of its shares,

¹ Conant, p. 289.

beside receiving dividends at the rate of about $8\frac{3}{8}$ per cent annually. The aggregate payments by the Government, including interest, were \$2,636,427, while the proceeds and dividends together were \$3,773,580, representing a profit of nearly 57 per cent on the original investment for the eleven years during which the Government was a shareholder.¹

FINANCIAL CONDITION.

The act provided that a report of the condition of the bank should be furnished to the Secretary whenever required by him, but not oftener than once a week. The Treasury records do not show that any formal reports were ever made to the Department, and the only balanced statements to be found showing the condition of the bank are two, which are contained in letters of Albert Gallatin, Secretary of the Treasury, communicated to Congress on March 2, 1809, and January 24, 1811, respectively. The reports are as follows:

<i>Resources.</i>	JANUARY, 1809.	JANUARY, 1811.
Loans and discounts	\$15,000,000	\$14,578,294
United States six per cent stock	2,230,000	2,750,000
Other United States indebtedness .....	.....	57,046
Due from other banks	800,000	894,145
Real estate	480,000	500,653
Notes of other banks on hand .....	.....	393,341
Specie	5,000,000	5,009,567
Totals	<u>\$23,510,000</u>	<u>\$24,183,046</u>
<i>Liabilities.</i>		
Capital stock	\$10,000,000	\$10,000,000
Undivided surplus	510,000	509,678
Circulating notes outstanding	4,500,000	5,037,195
Individual deposits	8,500,000	5,900,423
United States deposits .....	.....	1,929,999
Due to other banks .....	.....	633,348
Unpaid drafts outstanding .....	.....	171,473
Totals	<u>\$23,510,000</u>	<u>\$24,183,046</u>

It is evident from the above that the first of these reports is only an approximate statement of the bank's condition. I do not know, however, that its accuracy, as such a statement, has ever been impeached, and the figures given above may be taken as indicative of the bank's true financial condition. The showing on the face of the reports, it will be seen, is a strong one—a note circulation of only 50 per cent of the authorized maximum, and at each date covered practically in full by specie, which indeed amounted to nearly 40 per cent of the total liabilities of the bank to the public.

¹ Conant, p. 291.

Little can be said of the operation of the bank during these earlier years. Its record of dividends and condition at the expiration of its charter in 1811 shows that it was administered in such a way as to be a financial success; while its services to the Treasury were almost beyond calculation, and its beneficial influence in restraining the notes of the smaller banks, at a time when there was much disorder owing to the rapid development of banking among those who had no previous experience, cannot be too highly commended.

Failure to Secure Renewal of Charter.

Although the charter was not to expire until 1811, the directors thought it advisable as early as 1808 to apply to Congress for a renewal. Their memorial was referred by the Senate to Albert Gallatin, Secretary of the Treasury, who, on March 2, 1809, presented a report reviewing the history of the bank. Madison, who was then President, had voted against the original charter, and, though perhaps at this time acquiescent, could hardly be considered favorable to the bank, but in spite of a very strong sentiment against the bank within his party, Gallatin strongly supported it.

GALLATIN'S REPORT.

He recommended that its capital be increased to \$30,000,000—\$5,000,000 of the increase to be taken by private citizens, to be equitably apportioned among the several States and territories, and \$15,000,000 by the several States, each State to have a branch within its borders if it desired. He also proposed that the bank should pay interest on Government deposits in excess of \$3,000,000, and that it should be obliged to lend the United States at any time, not to exceed 60 per cent of its capital, at 6 per cent interest. By this means Gallatin intended that the United States should be getting some revenue from the bank in the shape of interest upon its deposits when the Treasury had a surplus and could rely upon a loan from it of \$18,000,000 in time of emergency.

Gallatin also dwelt at some length upon the history of the bank in the seventeen years of its existence, and its present condition, and the advantages which the Government had derived from it. He concluded "that the affairs of the bank as a moneyed institution had been wisely and skillfully managed." He enumerated the advantages the Government had received as consisting of the safe keeping of public deposits, the transmission of public moneys, aid in collection of revenues by means of the punctuality of payments introduced by its system, the facilities granted to importers, and the loans that, as long as the necessities of the

Treasury required, were made to it by the bank. The loans thus made amounted to \$6,200,000.

Of the total 25,000 shares of stock Gallatin reported that at this time 18,000 were owned abroad, mainly in England; but as foreign shareholders could not vote, the bank was controlled by the stockholders in the United States owning the remaining 7,000 shares. This fact of foreign ownership was seized upon by the enemies of the bank and the personal enemies of the Secretary to inflame popular prejudice. Anticipating this ground of objection, Mr. Gallatin said in his report of March 2, 1809:

"The strongest objection against the renewal of the charter seems to arise from the great portion of the bank stock held by foreigners—not on account of any influence it gives them over the institution, since they have no vote, but of the high rate of interest payable by America to foreign countries, on the portion thus held. If the charter is not renewed, the principal of that portion, amounting to about \$7,200,000, must at once be remitted abroad; but if the charter is renewed, dividends equal to an interest of about eight and a half per cent a year, must be annually remitted in the same manner. The renewal of the charter will in that respect operate, in a national point of view, as a foreign loan, bearing an interest of $8\frac{1}{2}$ per cent a year. That inconvenience might, perhaps, be removed by a modification in the charter providing for the repayment of that portion of the principal by a new subscription to the same amount, in favor of citizens; but it does not, at all events, appear sufficient to outweigh the manifest public advantages derived from the renewal of a charter."

THE DEBATE IN CONGRESS.

When Congress met in 1809 several measures were introduced having reference to the continuance of a national bank all more or less modeled upon Mr. Gallatin's recommendations. One was a bill to establish a new national bank in Washington with a capital of \$15,000,000 to be subscribed by the United States, the States and individual citizens and corporations. The others were for the extension of the existing bank, with provision for a bonus to be paid to the Government either in money or bank stock, and for the increase of capital. No action was taken at this session of Congress. The bill to continue the charter came up again in December, 1810. The question of the constitutionality of the bank was immediately raised by Mr. Burwell, of Virginia, but it was contended by Mr. Fisk, of New York, that since Mr. Jefferson's election the party he represented had twice virtually admitted the constitutionality of the measure, once in selling a large part of the shares of the bank,

which sale, although made to a foreigner, Mr. Baring, was sanctioned by the vote of the House of Representatives in 1802, and again by the passage of an act in 1804 authorizing the bank to establish branches in the territories. Mr. Fisk went on to show the danger and difficulty that would ensue in the financial operations of the country and Government if dependence was had on State banks alone. The destruction of the bank would result in doubling the quantity of State bank paper. He spoke of numerous applications made for new bank charters, and regarded them as the evidence of the destroying spirit of speculation which threatens to stand upon the ruins of the United States Bank until the country shall be overwhelmed with emissions of paper from these new manufactories.

Mr. Desha, of Kentucky, worked himself up to a most remarkable state of fury. The question, he said, was whether we will foster a viper in the bosom of our country that will spread its deadly venom on the land and finally affect the vitals of our republican institutions, or whether we will, as is our duty, apply the proper antidote by a refusal to renew the charter, thereby checking the cankering poison. He thought the bonus offered by the bank was a bribe offered to the nation. He had no doubt but that George III was a principal stockholder in the bank, and that the English monarch regarded it as an instrument in effecting his nefarious purposes against the United States, and would bid up several millions of dollars rather than not have the charter renewed. This was a safer method than encountering Americans in arms. Of that we made him extremely tired when we were in a state of infancy.¹

The discussion which took place was prolonged for several weeks, the final result in the House being its postponement by a vote of 65 to 64, on January 24, 1811. The bank was not without friends even among the Republicans. The best speech made for the new charter was that of Senator Crawford of Georgia—a masterly effort from nearly every point of view. Mr. Crawford gives us a glimpse of journalism in his day:

The democratic presses in these *Great States* have, for more than twelve months past, teemed with the most scurrilous abuse against every member of Congress who has dared to utter a syllable in favor of the renewal of the bank charter. The member who dares to give his opinion in favor of the renewal of the charter is instantly charged with being bribed by the agents of the bank—with being corrupt—with having trampled upon the rights and liberties of the People—with having sold the sovereignty of the United States to foreign capitalists—with being guilty of perjury by having violated the Constitution. Yes, sir; these are the circumstances under which we are called upon to reject the bill. When we compare the circumstances under which we are now acting, with those which existed at the time when the law was passed to incorporate the bank.

¹ Knox, p. 496.

we may well distrust our own judgments. Sir, I had always thought that a corporation was an artificial body, existing only in contemplation of law; but if we can believe the rantings of our Democratic editors in these great States, and the denunciations of our public declaimers, it exists under the form of every foul and hateful beast, and bird, and creeping thing. It is a *Hydra*; it is a *Cerberus*; it is a *Gorgon*; it is a *Vulture*; it is a *Viper*. Yes, sir; in their imaginations it not only assumes every hideous and frightful form, but it possesses every poisonous, deleterious and destructive quality. Shall we, sir, suffer our imaginations to be alarmed and our judgments to be influenced by such miserable stuff? Shall we tamely act under the lash of this tyranny of the press? No man complains of the discussion in the newspapers of any subject which comes before the Legislature of the Union; but I most solemnly protest against the course which has been pursued by these editors in relation to this question. Instead of reasoning, to prove the unconstitutionality of the law, they charge members of Congress with being bribed or corrupted; and this is what they call the liberty of the press. To tyranny, under whatever form it may be exercised, I declare open and interminable war. To me it is perfectly indifferent whether the tyrant is an irresponsible editor or a despotic monarch.

He concluded with the following words:

Sir, we have the experience of twenty years for our guide. During that lapse of years your finances have been, through the agency of this Bank, skillfully and successfully managed. During this period the improvement of the country and the prosperity of the nation have been rapidly progressing. Why, then, should we, at this perilous and momentous crisis, abandon a well-tried system, faulty, perhaps, in the detail, but sound in its fundamental principles? Does the pride of opinion revolt at the idea of acquiescing in the system of your political opponents? Come! and with me sacrifice your pride and political resentments at the shrine of practical good. Let them be made a propitiatory sacrifice for the promotion of the public welfare, the savor of which will ascend to Heaven and be there recorded as a lasting, an everlasting, evidence of your devotion to the happiness of your country.

The vote in the Senate on February 20, 1811, was a tie—17 to 17—whereupon George Clinton, the Vice-President, gave the casting vote against the bank. It was accordingly put in liquidation. The country went to war the following year, leaning upon the State banks for financial support. All, except those of New England and a very few in the West and South, suspended in September, 1814, after which the country wallowed in irredeemable paper, at all sorts of discount, for several years. If the bank charter had been renewed in 1811, it is almost certain that specie payments would have been maintained. This was Mr. Gallatin's opinion. In an essay published in 1831, after alluding to the banking speculations which sprang from a desire to fill the void left by the Bank of the United States—120 new banks being chartered and put in operation in the space of three years—he said:

It is our deliberate opinion that the suspension might have been prevented at the time when it took place had the former Bank of the United States been still in existence. The exaggerated increase of State banks, occasioned by the dissolution of that institution, would not have occurred. That bank would, as

before, have restrained within proper bounds and checked their issues, and through the means of its offices (branches) it would have been in possession of the earliest symptoms of the approaching danger. It would have put the Treasury Department on its guard; both acting in concert would certainly have been able at least to retard the event, and as the treaty of peace was ratified within less than six months after the suspension took place, that catastrophe would have been altogether avoided.

So the first Bank of the United States stumbled over politics in spite of itself and disappeared.¹

The Bank in Liquidation.

After the final rejection of the bill for the recharter the bank presented a further memorial to both the House and Senate asking for a temporary extension of their powers for two years to enable them to close up their affairs. In each case the memorial was referred to a committee, and both committees reported adverse to granting the prayer of the memorialists.²

The Trustees of the Bank of the United States applied for charters for new banks to succeed to the business to the Legislatures of New York and Pennsylvania. The charter of the Bank of America was finally granted by the State of New York after some exciting episodes in the Legislature of that State, continuing for a year or two, the history of which is included in that of the Bank of America, of New York. The Bank of Commerce was the name desired in the application of the Trustees to the State of Pennsylvania. It was reported favorably upon by a Grand Committee of 31 members. The bill provided for a bank with a capital of \$7,500,000, to continue till 1832.

The banking house and most of the assets of the Bank of the United States, including over five millions of dollars in specie, were purchased by Stephen Girard, of Philadelphia, who at once started the Girard Bank, which, converted to a national bank in 1865, continues to this day. The purchase and transfer came about in this way: In 1810 Girard had large balances with the Barings, amounting to £116,701. In 1811 the indebtedness of that firm to him was nearly £200,000. The difficulties in trade with the Continent were great and the Barings were in danger. Mr. Girard sent two agents to London to do what they could to withdraw the amount due and transmit it to America. Part of the funds were invested in goods and part in American 6 per cent stocks and United States Bank shares, then at about \$430 $\frac{1}{3}$ (£98 10.) per share. The Barings, it will be remembered, had purchased a large

¹ White, pp. 269, 270.

² The Committee of the House reported, through its chairman, Henry Clay, "that, holding the opinion (as a majority of the Committee do) that the Constitution did not authorize Congress originally to grant the charter, it follows as a necessary consequence of that opinion, that an extension of it, even under the restrictions contemplated by the stockholders, is equally repugnant to the Constitution."

amount of the bank stock from the United States Government in 1804. The stock Girard had purchased gave him a large interest in the bank; and in the spring of 1812 he found, by consultation with George Simpson, the cashier of the old institution, that the bank building and cashier's house could be purchased for \$120,000—less than one-third of its cost. The purchase was made, the property was transferred to Girard, and his new bank commenced operations on May 12, 1812, with a capital of \$1,200,000, which was afterward increased to \$1,300,000.

Much of the business of the Bank of the United States was transferred to Girard's bank, together with \$5,000,000 in specie. The officers and employees of the old bank were retained at the same salaries. Girard bought the stock expecting the charter of the Bank of the United States to be renewed. If this had occurred, he would have made a fortune by the rise in stock. But, as it was, he saved himself by the purchase of the old bank. He did not use the old circulating notes, but paid out notes of State banks till his own were printed, which bore the device of a ship under full sail and an American eagle.¹

The final return to the stockholders of the Bank of the United States was \$434 for each \$400 share.

Contemporaneous Bank Currency.

At the time the Bank of the United States was established, in 1791, there were in the country only three other banks issuing notes—the Bank of North America, the Massachusetts Bank and the Bank of New York. The latter, as noted above, was an unincorporated association, but within a month from the date of the signing of the act chartering the United States Bank, the Bank of New York was incorporated by the Legislature of that State.²

At this time its paid-up capital was only \$318,250, and its notes in circulation \$181,254.

The establishment of banks in the several States followed rapidly. There is little information, however, as to the extent and character of their operations.

The following statement, made up from a report by Secretary Crawford in 1836, who secured most of the data from Blodgett's *Economica*,

¹ Knox, pp. 499, 500.

² It is interesting to note the similarity between the charter of the Bank of New York and that of the Bank of the United States. Some of the provisions—*e.g.*, the ineligibility of a portion of the directors for re-election; the means employed to give greater proportional voting strength to the smaller shareholders; the admission of proxies only in the case of residents, etc.—appears to have been first applied in the Constitution of the Bank of New York in 1784, and later in the Charter of the United States Bank. In other instances the substance, and even phraseology, of the Charter of the United States Bank was copied in the New York act.

will serve to indicate the growth of the State banking in the period covered by the charter of the First Bank of the United States:

YEAR	NO. OF BANKS	CIRCULATION	CAPITAL	METALLIC CIRCULATION OF COUNTRY
1790.....	4	\$2,500,000	\$2,500,000	\$9,000,000
1791.....	6	9,000,000	12,900,000	16,000,000
1792.....	16	11,500,000	17,100,000	18,000,000
1793.....	17	11,000,000	18,000,000	20,000,000
1794.....	17	11,600,000	18,000,000	21,500,000
1795.....	23	11,000,000	19,000,000	19,000,000
1796.....	24	10,500,000	19,200,000	16,500,000
1797.....	25	10,000,000	19,200,000	16,000,000
1798.....	25	9,000,000	19,200,000	14,000,000
1799.....	26	10,000,000	21,200,000	17,000,000
1800.....	28	10,500,000	21,300,000	17,500,000
1801.....	31	11,000,000	22,400,000	17,000,000
1802.....	32	10,000,000	22,600,000	16,500,000
1803.....	36	11,000,000	26,000,000	16,000,000
1804.....	59	14,000,000	39,500,000	17,500,000
1811.....	88	22,700,000	42,610,000	30,000,000

It was in New England, however, Mr. Gouge tells us,¹ that banking operations were carried furthest. The author of a pamphlet entitled *Remarks on Money*, published at Philadelphia, in 1814, says some of the institutions in that quarter issued bills for so small a sum as twenty-five cents. Certainly there was much looseness there in the earlier years of the century, as evidenced by the circumstances attending the failure of the Farmers' Bank of Gloucester, in Rhode Island, and several New Hampshire and Massachusetts banks.

South of New England, according to the same authority, the banking system was, in some respects, less pernicious. The notes of the banks were convertible into gold or silver. The Bank of the United States issued no notes of a less denomination than ten dollars, whereby it was enabled to exercise a salutary control over the local banks.

The Second United States Bank, by L. Carroll Root.²

Adapted from Sound Currency, vol. IV, No. 17, pp. 2-18.

Conditions Prior to its Establishment.

The First United States Bank went into liquidation in 1811. Its friends had worked strenuously to secure a renewal of its charter, and

¹ Gouge, Wm. M. *The Curse of Paper Money and Banking; or, A Short History of Banking in the United States.* 1833.

² For fuller information in regard to the Second Bank of the United States, see the works noted below. In the preparation of this sketch free use has been made of the results of the investigations of White, Sumner, Catterall, Conant and others, to whom especial indebtedness is here acknowledged.

Clark, M. St. Clair, and Hall, D. A.—*Legislative and Documentary History of the Bank of the United States, including the original Bank of North America.* 1832.

Catterall, Ralph C. H.—*The Issues of the Second Bank of the United States*, in the *Journal of Political Economy*, September, 1897, pp. 421-457.

White, Horace.—*Money and Banking*, pp. 271-313.

had failed. They had predicted a financial crisis as a consequence of its dissolution.¹ But it did not come. As a matter of fact there was no such contraction of bank credits as they had anticipated. For no sooner was it known that the United States Bank was not to be continued than there ensued such a rush of capital into banking that whatever chasm there might have been was soon more than filled. Gallatin in 1831 estimated that there were in 1811 88 banks in the United States, in addition to the United States Bank. The estimated capital and circulation of these were \$42,600,000 and \$22,700,000, respectively. Four years later there were 208 banks, with a capital of \$82,260,000 and note circulation of \$45,500,000. In other words, to compensate for the withdrawal of \$10,000,000 of capital and \$5,400,000 of notes on the part of the United States Bank there was an expansion of \$40,000,000 in the capital of the State banks and \$22,000,000 in their note circulation.

This increase in banking capital was, however, more apparent than real—resting in large measure on no substantial basis. The mode of raising capital, very generally employed, illustrates this. A first installment might, perhaps, be actually raised by the subscribers; but after the organization of the bank subsequent installments were met by discounting the notes of the stockholders. Under more favorable methods, so sudden an expansion of currency as that which occurred in the years 1811–1814 might have caused apprehension; but under the very loose system alluded to it could not but end disastrously.

SUSPENSION OF SPECIE PAYMENTS.

The great overissue of notes which took place, coupled with the extremely unsound condition of the banks in the most of the country and the unsettled state of commerce brought on by the war with Great Britain, led to the suspension of specie payments in August and September, 1814, by practically all the banks in the country except those in New England.²

Thus relieved of the necessity for redeeming their obligations on demand, the banks outside of New England rushed wildly into further emissions. Their specie had already been driven from them, partly for

Conant, Chas. A.—*History of Modern Banks of Issue*, pp. 293-309.

Sumner, W. G.—"History of Banking in the United States" (Vol. I of *History of Banking in all Nations*), pp. 63-102, 183-224.

Knox, John J.—"History of Banking in the United States," in *Rhodes' Journal of Banking*, May, 1892, Vol. XIX., pp. 500-520.

Bolles, A. S.—*Financial History of the United States*, Vol. II., pp. 261-283, 317-358.

Goddard, Thos. H.—*A General History of Banks, etc.*, 1831, pp. 88-181.

Poor, Henry W.—*Money and its Laws*, pp. 483-538.

Gouge, Wm. M.—*A Short History of Paper Money and Banking in the United States*. 1833.

Gilbart, J. W.—*History of Banking in America*, pp. 11-41.

¹ See for example, M. Carey's *Nine Letters to Dr. Adam Seybert*, Philadelphia, 1810.

² The banks of Ohio and Kentucky appear to have maintained specie payments until December or January, and the Bank of Nashville, Tenn., until August, 1815. (See Gouge, *Curse of Paper Money and Banking*, p. 19.)

payment of foreign obligations and partly for transmission to New England, where better banking methods, coupled with heavy penalties for failure to redeem on demand, maintained the circulation on a par with specie and fully convertible.¹

The result, except in the New England States, was a currency composed wholly of depreciated paper.²

Gallatin gives the following table showing the depreciation by months:

SCALE OF DEPRECIATION OF BANK CURRENCY PER CENT AT BALTIMORE,
PHILADELPHIA AND NEW YORK.

	Balti- more	Phila- delphia	New York		Balti- more	Phila- delphia	New York
1814, Sept.	20		10	1815, Dec.	18	14	12½
Oct.	15		10	1816, Jan.	15	14	12½
Nov.	10		11	Feb.	13	14	9
Dec.	14		11	March	18	12½	12½
1815, Jan.	20		15	April	23	14½	10
Feb.	5		2	May	20	14	12½
March	5		5	June	20	17	12½
April	10		5½	July	15	15	6
May	14	5	5	Aug.	12	10	5
June	16	9	11½	Sept.	10	7½	3
July	20	11	14	Oct.	8	9½	2
Aug.	19	11	12½	Nov.	9	7	1¾
Sept.	20		13	Dec.	9	7	2¼
Oct.	21½	15	16	1817, Jan.	3	4½	2½
Nov.	15	16	12½	Feb.	2½	4	2½

Unfortunately while the circulation was in this already serious condition, the Secretary of the Treasury continued to receive the notes of suspended banks at par in payments to the Government. A premium was thus set on depreciation, so strong as to shift the main point of importation to Baltimore, where the worst money was most plentiful.

A National Bank Proposed.

"Naturally men's minds reverted to the earlier Bank of the United States. During its lifetime the bank had regulated the currency besides helping the Government in critical times. It had achieved this end by the force of example rather than by overt act. Its own notes were always equal to specie. The State banks were obliged to keep their notes up to the same standard since otherwise they would be thrown out by the great

¹ The following is a statement of the specie holdings of the Massachusetts banks during the period in question:

1811.....	\$1,513,000	1815.....	\$3,454,241
1812.....	3,681,696	1816.....	1,260,210
1813.....	5,780,796	1817.....	1,577,432
1814.....	6,946,542		

² "On the 19th of November, or eighty days after the suspension of specie payments, the paper of the best banks of Philadelphia was at fourteen per cent discount." Gouge, p. 22.

"In the Southern and Western States the depreciation in some instances exceeded even twenty-five per cent." N. Am. Rev., Vol. XXXII, p. 546.

bank and no longer be received for government dues, and in the principal cities their best customers would transfer their accounts to the bank or its branches. The phrase 'Regulator of the Currency,' as applied to the two Banks of the United States, has no other significance, but this was discovered to be of immense importance when suspension took place in September, 1814."¹

On October 6, 1814, Mr. Dallas was appointed Secretary of the Treasury; and on the 14th of the same month he transmitted to Congress a report strongly recommending the organization of a National bank. In that report he says:

The multiplication of State banks in the several States has so increased the quantity of paper currency that it would be difficult to calculate its amount and still more difficult to ascertain its value. . . . There exists, at this time, no adequate circulating medium common to the citizens of the United States. The moneyed transactions of private life are at a stand, and the fiscal operations of the Government labor with extreme inconvenience. . . . Under favorable circumstances, and to a limited extent, an emission of Treasury notes would probably afford relief; but Treasury notes are an expensive and precarious substitute either for coin or bank notes, charged as they are with a growing interest, productive of no countervailing profit or emolument, and exposed to every breath of popular prejudice or alarm. The establishment of a National institution, operating upon credit, combined with capital, and regulated by prudence and good faith, is, after all, the only efficient remedy for the disordered condition of our circulating medium. The establishment of a National bank will not only be useful in promoting the general welfare, but it is necessary and proper for carrying into execution some of the most important powers constitutionally vested in the Government.

On October 17th, in response to a communication from John W. Eppes, Chairman of the Committee of Ways and Means, as to the best means of sustaining the public credit, Secretary Dallas wrote, recommending the incorporation of a National bank, to be established at Philadelphia, with a capital of \$50,000,000. Two-fifths of the stock was to be taken by the Government. The subscriptions, with the exception of \$600,000 in specie, were to be in 6 per cent stock or Treasury notes. The capital and circulation and all property of the bank except real estate was to be exempt from National and State taxation; no other bank was to be incorporated by Congress during its life of twenty years; it was to have branch offices of discount and deposit, and its accounts were to be subject to the inspection of the Secretary of the Treasury.

On November 13, 1814, a bill was introduced by Mr. Fisk, of the Committee of Ways and Means, which seems to have followed closely the plan of Secretary Dallas. This bill was taken up in Committee of the Whole, and, after some debate, Mr. Calhoun proposed a substitute by which all the stock was thrown open to individual subscription—none

¹ White, *Money and Banking*, p. 272.

to be taken by the United States. The subscriptions were to be paid for, one-tenth in specie, and the remainder in Treasury notes. Mr. Calhoun believed this would sustain at par a new issue of Treasury notes, which would give immediate relief to the Government. After a debate lasting four days Mr. Calhoun's substitute was agreed to by a majority of about 60 votes.

The House had by this substitution rejected the provision requiring a loan of \$30,000,000 to the Government, and had also struck out the permission given to the bank to suspend specie payments under certain conditions, and had given it permission to sell any of the public stocks it might receive for subscriptions. Another important change in the plan of the Secretary was the reduction in the capital from \$50,000,000 to \$30,000,000.

The Secretary of the Treasury opposed the bill in its amended form, and on its coming to a vote on November 28, 1814, it failed to pass.

A bill similar to that first introduced in the House was taken up in the Senate on December 2d, and passed on December 9th. By it the capital of the proposed bank was to be \$50,000,000, and it was bound to lend \$30,000,000 to the Government. While the war lasted it had the right to suspend specie payments in certain contingencies, and was also during that period prohibited from selling any United States stocks received in subscriptions to its capital. This bill was rejected by the House on January 2, 1815, the vote standing 81 in favor to 80 against—Mr. Cheves, the Speaker, making it a tie vote.

In the debate upon this measure, Daniel Webster had opposed with great force several of its provisions, notably the proposition to permit the bank to commence operations under suspension of specie payments.¹

Mr. Webster had indicated that, if certain amendments were adopted, he and his friends would be willing to vote for the measure. Among these the most important were the reduction of the capital, the striking

¹ "Whenever bank notes are not convertible into gold or silver at the will of the holder, they become of less value than gold and silver. All experiments on this subject have come to the same result. It is so clear, and has been so universally admitted, that it would be waste of time to dwell upon it. The depreciation may not be sensibly perceived the first day or the first week it takes place. It will first be discerned in what is called the rise of specie; it will next be seen in the increased price of all commodities.

"The circulating medium of a commercial community must be that which is also the circulating medium of other commercial communities, or must be capable of being converted into that medium without loss. It must be able, not only to pass in payments and receipts between individuals of the same society or nation, but to adjust and discharge the balance of exchanges between different nations. It must be something which has a value abroad, as well as at home, and by which foreign as well as domestic debts can be satisfied. The precious metals alone answer these purposes.

"They alone, therefore, are money, and whatever else is to perform the offices of money must be their representative, and capable of being turned into them at will. So long as bank paper retains this quality, it is a substitute for money; divested of this, nothing can give it that character.

"No solidity of funds, no sufficiency of assets, no confidence in the solvency of banking institutions has ever enabled them to keep up their paper to the value of gold and silver any longer than they paid old and silver for it on demand. This will continue to be the case as long as these metals shall continue to be the standard of value and the general circulating medium among nations. . . .

"Other institutions, setting out perhaps on honest principles, have fallen into discredit

out of the right to suspend specie payments, the requirement of a loan to the Government, and the provision restraining the bank from selling stock during the war. When the Committee again reported the bill these amendments had been adopted, and the measure was passed by a vote of 120 to 87. After some conference, on January 20th, the Senate agreed to it in its amended form.

The bill was now, so far as essentials were concerned, in precisely the same form that had been pronounced inadequate to the necessities of the Government by Secretary Dallas, in his letter of November 27, 1814. On January 30, 1815, it was vetoed by President Madison, on the same grounds of objection taken by the Secretary of the Treasury.¹

On February 2, 1815, the Senate refused to pass the bill over the President's veto, and, on the 6th, Mr. Barbour again introduced the bill in its original form, and it again passed the Senate on February 10, 1815; but the House postponed it indefinitely on February 13th by a vote of 74 to 73.²

Thus the war plan of Secretary Dallas had been rejected by Congress, and the measure adopted by Congress in 1815 had been in turn rejected by President Madison as being insufficient for the necessities of war.

In December of 1815 Secretary Dallas again broached the subject to Congress. He considered the place in a currency system of specie and the State banks, and finally concluded that a National bank was the best and perhaps only resource.

The Second United States Bank Established.

At the request of the Committee of the House having the matter in charge, Mr. Dallas, on December 24, 1815, submitted an outline of a plan for a National bank. He now proposed a bank chartered for twenty years with a capital of \$35,000,000,³ seven million dollars of

through mismanagement or misfortune. But this bank is to begin with insolvency. It is to issue its bills to the amount of thirty millions at least, when everybody knows it cannot pay them. It is to commence its existence in dishonor. It is to draw its first breath in disgrace. The promise contained in the first note it sends forth is to be a false promise; and whoever receives the note is to take it with the knowledge that it will not be paid according to the terms of it. . . ."

¹ Its capital was not large enough; and part of that capital was to be made up of Treasury notes. It was not under obligation to make any loans to the Government. The bank being compelled to redeem its notes in specie, in time of war, its notes could not be kept in circulation to the extent required by the Government. The capital being so small the amount of public stocks subscribed for would have but little effect in enhancing the market value of the stocks; and even this effect the bank was permitted to counteract by the sale of the securities it received, being tempted to dispose of them to obtain the specie it might require to circulate its notes. On the whole, the law would make the bank very profitable to itself in time of peace, but of little use to the Government in time of war. He waived the question of constitutional authority of the Legislature to establish an incorporated bank as being precluded, in his judgment, by repeated recognitions, under varied circumstances, of the validity of such an institution in Acts of the Legislative, Executive and Judicial branches of the Government, accompanied by indications, in different modes, of a concurrence of a general will of the Nation.

² Knox, *Rhodes' Journal of Banking*, May, 1892, p. 503.

³ This might be augmented to \$50,000,000 by Congress, the increase to be divided among the States.

which was to be subscribed by the Government. It was to be located at Philadelphia, and might establish branches or employ State banks as branches. It was to pay specie at all times, and not to suspend without authority of Congress. In lieu of the requirement of a loan, it was to pay the Government a bonus of \$1,500,000. Thus, in time of peace the administration had come to the terms which Congress had shown itself willing to accede to in time of war.

A bill was introduced embodying Mr. Dallas' suggestions upon February 26, 1816.

Mr. Calhoun reported the bill to the House in a speech in which he said:

A national bank paying specie itself would have a tendency to make specie payments general, as well by its influence as by its example. It will be the interest of the national bank to produce this state of things; because, otherwise, its operations will be greatly circumscribed, as it must pay out specie or national bank notes; for one of the first rules of such a bank is to take the notes of no bank which did not pay in gold and silver. A national bank of thirty-five millions, with the aid of those banks which are at once ready to pay specie, would produce a powerful effect all over the Union. Further, a national bank would enable the government to resort to measures which would make it unprofitable to banks to continue the violation of their contracts, and advantageous to return to the observation of them. The leading measure of this character would be to strip the banks refusing to pay specie of all the profits arising from the business of the government—to prohibit deposits with them, and to refuse to receive their notes in payment of dues to the government.

The debate was chiefly upon a motion to reduce the capital to \$20,000,000.¹

In this debate Mr. Clay spoke in favor of the bank. The reasons he gave for changing his position were that, in 1811, when he voted against the recharter of the old bank, he was instructed by the Legislature of his State to do so, and at that time he did not deem a National bank as necessary in a constitutional sense. He then relied upon the State banks as being able to meet all the wants of the Government financially; but it now appeared that the General Government could no longer depend upon them. A National bank seemed to him now not only necessary, but indispensable.

The bill finally passed the House without important amendment, on March 14, 1816, by a vote of 80 to 71. It was introduced in the Senate on March 22d, and passed on April 3d, with one or two amendments that, when the bill came to the House next day, Mr. Calhoun pronounced to be slight. Upon the 5th day they were concurred in, and on the 10th received President Madison's signature.

¹ At one time Philadelphia was struck out and New York selected as the principal seat of the bank by a vote of 70 to 64, but this was reconsidered and Philadelphia replaced.

PROVISIONS OF CHARTER.

1. **Capital stock.**—The capital was fixed at \$35,000,000, divided into 350,000 shares of \$100 each. One-fifth of this, \$7,000,000, was to be subscribed by the United States. The remaining \$28,000,000 was to be open to subscriptions by individuals and corporations—no one being permitted to subscribe for more than 3,000 shares (\$300,000) unless upon opening the subscriptions the entire \$28,000,000 should not have been subscribed.¹

2. **Payment of subscriptions.**—The \$28,000,000 of public subscriptions was to be paid as follows: \$7,000,000 in specie and \$21,000,000 either in specie or in funded debt of the United States.²

Of this at the time of subscribing there was to be paid upon each \$100 share \$5 in specie and \$25 in specie or bonds; six months later (January 7, 1817), a second installment of \$10 specie and \$25 in bonds; and after a further interval of six months the remainder—\$10 in specie and \$25 in bonds.

The government subscription was to be paid for either in specie or in 5 per cent. stock at par—the latter being the method of payment actually followed.

3. **Administration.**—The management was in a board of twenty-five directors (to serve without compensation), all stockholders and residents of the United States, and no more than three from any one State. No one could be a director of the Bank of the United States who was a director of any other bank. The directors held office for one year only. Five were appointed by the President of the United States, and the other twenty elected by the stockholders—the president of the bank to be elected by the directors from among their own number. Not more than three-fourths of the directors annually elected and not more than four of the five directors appointed were to be eligible as directors for the succeeding year.³

An attempt was made to protect the interests of small stockholders, as in the case of the First Bank, by granting to them greater proportional voting power.⁴

¹ As a matter of fact, the subscriptions lacked \$3,038,300 of making up the \$28,000,000. This amount was subscribed by Stephen Girard, of Philadelphia.

² To be accepted at these rates: 6 per cent stock at par; 3 per cent stock at 65; 7 per cent stock at 106.51—together in each case with accrued interest.

³ This will be recognized as due to Hamilton's ideas about rotation in office as expressed in his original report recommending a National Bank.

⁴ This did not always work just as it was intended to. "The arrangement about voting on stock in the bank, although it was universal and had been borrowed from England, proved mischievous. Some gentlemen at Baltimore who had had great experience in organizing financial institutions had devised the plan of subscribing by attorney. George Williams, a government director, took 1,172 shares as attorney in the name of 1,172 different persons. In his testimony before the Committee of 1819 he declared that this was a common procedure, which, indeed, it was, and that the market price of proxies was eleven pence. Baltimore took in all 40,141 shares on 15,628 names, and got 22,137 votes out of 77,759, which was the total number of votes which all the stockholders were entitled to under the rule, taking the sub-

Stockholders resident abroad were not permitted to vote by proxy, and stockholders not citizens were not permitted to vote for directors at all.

4. **Relations to Government.**—As noted above, the United States subscribed for \$7,000,000 of stock, paying therefor in 5 per cent bonds. There was no requirement that the bank should make any loan to the Government; but in lieu of such an obligation and in consideration of exclusive privileges conferred, it was required to pay a bonus of \$1,500,000 in three equal annual installments, beginning after the second year of the bank's operation. The bank could not lend more than \$500,000 to the United States without authority by law. It was to act as the fiscal agent of the Treasury in transferring and disbursing the public moneys, and it was to do this without charging commissions or exchange; and the deposits of the public money in all places where the bank should have branches were to be made in such branches, unless the Secretary of the Treasury should otherwise direct—in which case he should lay before Congress the reason for such direction.

5. **Note issues.**—No notes under \$5 were to be issued, and all notes issued of less denomination than \$100 must be payable to bearer on demand. The maximum amount was not fixed directly, but in the same indirect way adopted in regulating the issues of the first Bank of the United States and other of the early banks of the country, by the provision that "the total amount of debts which the said corporation shall at any time owe, whether by bond, bill, note or other contract, over and above the debt or debts due for money deposited in the bank shall not exceed the sum of \$35,000,000 [the amount of capital], unless the contracting of any greater debt shall have been authorized by law."¹

The penalty for refusing to pay its notes or deposits in specie on demand was twelve per cent per annum until fully paid.²

scriptions as they were actually made. The clique at that place thus took less than one-seventh of the shares and got over one-fourth of the votes. At Philadelphia, where one-third of the shares were taken, only two-ninths of the votes were held."—Sumner, *History of Banking in the U. S.*, p. 73.

¹ "In case of excess, the directors under whose administration it shall happen, shall be liable for the same in their natural and private capacities; and an action of debt may in such case be brought against them, or any of them, their or any of their heirs, executors, or administrators, in any court of record of the United States, or either of them, by any creditor or creditors of the said corporation, and may be prosecuted to judgment and execution, any condition, covenant or agreement to the contrary notwithstanding. But this provision shall not be construed to exempt the said corporation or the lands, tenements, goods or chattels of the same from being also liable for, and chargeable with, the said excess.

"Such of the said directors, who may have been absent when the said excess was contracted or created, or who may have dissented from the resolution or act whereby the same was so contracted or created, may respectively exonerate themselves from being so liable by forthwith giving notice of the fact, and of their absence or dissent, to the President of the United States, and to the stockholders, at a general meeting, which they shall have power to call for that purpose."

² "The said corporation shall not at any time suspend or refuse payment in gold and silver, of any of its notes, bills or obligations; nor of any moneys received upon deposit in said bank, or in any of its offices of discount and deposit. And if the said corporation shall at any time refuse or neglect to pay on demand any bill, note or obligation issued by the corporation, according to the contract, promise or undertaking therein expressed; or shall neglect or refuse to pay on demand any moneys received in said bank, or in any of its offices aforesaid, on deposit, to the person or persons entitled to receive the same, then, and in every such case, the holder of any such note, bill or obligation, or the person or persons entitled to demand and

The bank was protected by stringent penal laws against counterfeiting or altering its notes.

The bills of the bank which were payable on demand were made "receivable in all payments to the United States, unless otherwise directed by act of Congress."¹

6. **Branches.**—The directors were empowered to establish branch offices of discount and deposit wherever they might think fit.²

For each branch, not less than seven or more than thirteen managers were to be annually appointed by the directors. Each was to be a citizen of the United States and a resident of the State in which the branch was established, and they were to elect a president from their own number.

7. **Reports.**—The Secretary of the Treasury was to be furnished, as often as he should require, not exceeding once a week, with statements of the condition of the bank; and to have the right to inspect its books.

8. **Other limitations.**—The bank was not forbidden to loan on real estate security, but could not hold real estate, beyond that necessary for its banking houses, unless it came into its hands in satisfaction of mortgage or judgments.

The Government was pledged to grant no other bank charter during the continuance of this one, which was to run for twenty years.

The bank could sell only \$2,000,000 of its Government stocks per year, and no part of that was to be sold within the United States without first offering it to the United States at the current price.

It was not, directly or indirectly, to deal in anything except bills of exchange, gold or silver bullion, goods pledged for money lent, or in the sale of goods really and truly pledged for loans, or the proceeds of its lands.

The Bank in Operation.

The 22d Section of its charter required the bank to commence business by the first Monday of April, 1817. The bank went into operation on January 7, 1817, on the very verge of a great financial crisis.

From the very first the bank failed to live up to its charter requirements. The subscriptions had been opened July 7, 1816. The first installment—\$1,400,000 in specie and \$7,000,000 in United States bonds—had been paid; but at the time it commenced business, January 7, 1817, the second installment became due. The law required this to be paid

receive such moneys as aforesaid, shall respectively be entitled to receive and recover interest on the said bills, notes, obligations or moneys, until the same shall be fully paid and satisfied, at the rate of twelve per centum per annum from the time of such demand as aforesaid."

¹ They were so received until by the Act of June 15, 1836—after the charter of the bank had expired—Congress repealed this section.

² Congress reserved the right, upon the application of any State in which two thousand shares were subscribed or held, to require the establishment of a branch in such State; also in the District of Columbia.

ten dollars in specie and twenty-five dollars in United States stock or specie. It appears, however, that instead of requiring the payment of this installment from outside sources, the bank on January 7th began to discount the notes of stockholders upon the pledge of their stock to the amount required to pay the specie part, and in some cases to the full amount of both specie and United States stock required to make up the whole installment.¹ After a time discounts were made to the full value of the stock, which enabled the stockholders to even draw out what they had first advanced. The discounts were made in the bank's bills, which were considered equal to specie. Of the \$28,000,000 capital subscribed by individuals \$7,000,000 was to have been paid in specie and \$21,000,000 in United States stock. The bank appears to have actually received nearly \$2,000,000 in specie and \$13,872,610 in public stocks. The difference represents about the amount made up by loans to stockholders. The bank, therefore, was forced to import the coin it needed, and up to November, 1818, had thus acquired \$7,311,750 in specie at an expense of \$525,297.²

The resort to this very reprehensible practice of discounting stockholders' notes in lieu of requiring the payment of stock subscriptions in full was responsible for many of the disasters of our earlier banking history. But it was not the limit of the mismanagement of the United States Bank during the first years of its existence. The directors appear to have been very active in "booming" the stock, and did all possible to facilitate trading in it. The president, William Jones, and a number of the officers, were found to have engaged heavily in such transactions. At the Baltimore branch, especially, discounts were made with great recklessness and as a direct aid to the speculation in which the managers were interested. As a result, the bank sustained a loss at that branch estimated at \$1,671,221.87. The aggregate of the losses of the institution growing out of the operations which preceded the 6th of March, 1819, exceeded \$3,500,000. The bank at this time was on the verge of insolvency.³

A change of management, however, resulted in a great improvement. March 6, 1819, Langdon Cheves was elected president, and under his prompt and energetic leadership the affairs of the bank were soon put on a better footing.⁴

THE BANK'S INFLUENCE ON THE CURRENCY.

At the time the Second Bank went into operation the currency of the entire country outside of New England was in a most deplorable condi-

¹ Report of Investigating Committee, 1818.

² Knox, p. 506.

³ See Cheves' "Exposition," Goddard, p. 112.

⁴ In 1823, Mr. Cheves was succeeded as president by Mr. Nicholas Biddle.

tion. For more than two years the banks had made no pretense of redeeming their notes in specie; and the currency had depreciated more and more with each additional evidence of the unsoundness of existing conditions. This was the state of affairs which the second United States Bank was created to remedy.

In its stupendous task of restoring the currency of the country to par with specie the bank could hope for little assistance from the State banks. They had opposed its establishment because they knew it meant an effort to force a resumption of specie payments; and now that the bank was assured they were still interested to continue the suspension as long as possible. They were earning such dividends as never before. Being obliged to make no provision for the redemption of their notes, they could continue to issue them as long as there were those who wished to borrow. The debtor classes, too, opposed the resumption. Their indebtedness was being made lighter with each further step in the depreciation of the currency; while the dealers in domestic exchange reaped a rich harvest from the unequal depreciation in different parts of the country.

Before the bank went into operation efforts were made to induce the State banks to resume. Dallas's proposition to them was to begin the payment of coin in small sums on October 1, 1816; but they deemed such early action inexpedient. They desired to defer the time for resuming until the 1st of July in the following year. He strongly deprecated the delay. In his report to the House on the state of the finances,¹ made only a few days before resigning office, he set forth in the strongest light many reasons why the State banks should resume the next January, when the national bank was to begin paying in coin, or on the 20th of the following month, when coin payments were to be exacted by the Government for duties and other taxes.²

Both the Government, and the United States Bank, were desirous of hastening the return of specie payments. Even after the banks had agreed to resume in July, 1817, neither Crawford, who was Secretary of the Treasury, nor the managers of the bank had much faith that they would do so, unless outside influence could be brought to bear on them. The Bank of the United States, therefore, began negotiations with the State banks for the purpose of inducing them to agree to pay specie on the 20th of February, instead of postponing the time until the 1st of July. The result of these negotiations was favorable, and the leading

¹ September 30, 1816, 3 Finance, p. 129.

² This measure was a potent factor toward the resumption of specie payments. Congress passed a resolution on April 30, 1816, providing that all duties, taxes, and debts payable to the United States after the 20th day of February, 1817, should be paid in the "legal currency" of the Government, or treasury notes, or bills of the Bank of the United States, or of other banks which were paid on demand "in the legal currency of the United States."

banks of New York, Philadelphia, Baltimore and Richmond agreed to resume the payment of specie on February 20th. "The public deposits in these banks, which the government had been unwilling to accept in depreciated bank paper, were to be transferred to the Bank of the United States, but checks on the State banks which were parties to the agreement received by the Bank of the United States were to be credited as cash. Arrangements were also made for liberal discounts by the new bank in order to relieve the local banks from the commercial pressure."¹ During the years 1817 and 1818 the Government transferred to the United States Bank, from the State banks, \$7,472,419.87 of general and \$3,336,691.67 of special deposits.

"Under these circumstances," says Mr. Ralph C. H. Catterall in an admirable article in a recent number of the *Journal of Political Economy*, "specie payments were resumed on the 20th of February. At least that was the supposition at the time, but it was soon discovered that the resumption had been very incomplete indeed. In general, it was only nominal, and in no sense real. This is proved by the fact that specie was at a premium during the whole time that resumption presumably existed,² and also by the fact that the Bank of the United States had no means of keeping up specie payments in its own case except through the importation of specie, which was brought into the country at a great loss, and immediately went out again.³ The attempt to resume, then, was a failure. Undoubtedly this attempt was made too early. The currency was expanded to an astonishing degree, and there was too little specie in the country to make resumption actually possible. But there was a special cause for the failure which more nearly concerns us. The Bank of the United States was badly managed. Under these circumstances the country was overtaken by the panic of 1818-19, and all further thought of immediate resumption had to be surrendered. Indeed, the bank had all that it could do to take care of itself. The management had adopted at the beginning of the institution's existence the policy of expansion when the state of the currency demanded a contraction. This expansion was rendered more perilous by the excessive mismanagement of the bank, which allowed the southern and western offices to do a business altogether disproportionate to their legitimate business requirements. This again was helped along by the policy of redeeming all the bank's issues wherever presented. As the course of exchange was always against the West, and frequently against the South, this permitted the western and southern offices to issue their notes without any limitation whatever. The consequence was that the capital of the bank was drawn away to the South and West. To put an end to this serious condition of affairs the bank published orders in August, 1818, prohibiting the offices from redeeming notes not issued by the particular branch to which they were presented. By this order the usefulness and currency of the bank's issues were seriously impaired. Once more there was no common medium of exchange. The policy of refusing to receive these notes was, however, forced upon the bank, for it was upon the verge of bankruptcy.⁴ In this way the first attempt to give the country a better currency through the agency of the Bank of the United States ended in failure."

This language may be more severe than is justified by the facts. For

¹ Conant, p. 298.

² *Raguet on Banking*, p. 303. See also Crawford's Report of February 12, 1820. 3 Finance, p. 496.

³ For a table of importations, see 3 Finance, p. 338.

⁴ Letter of Cheves to Secretary Crawford, April 6, 1819. 4 Finance, p. 873.

while the bank did not succeed in securing a currency *fully* equal to specie, the depreciation of which Mr. Catterall complains was but slight when compared with the previous state of the currency; and there is every reason to believe that if the bank had not been established the resumption by the State banks, partial though it was, would have been deferred for a long time.

In support of the bank's claim to credit in restoring the currency to a specie basis, the following extracts are given:

It has been already stated that it [the Second United States Bank] has saved the community from the immense losses resulting from a high and fluctuating state of the exchanges. It now remains to show its effect in equalizing the currency. In this respect, it has been productive of results more salutary than were anticipated by the most sanguine advocates of the policy of establishing the bank. It has actually furnished a circulating medium more uniform than specie. This proposition is susceptible of the clearest demonstration. If the whole circulating medium were specie, a planter of Louisiana, who should desire to purchase merchandise in Philadelphia, would be obliged to pay one per cent either for a bill of exchange on this latter place, or for the transportation and insurance of his specie. His specie at New Orleans, where he had no present use for it, would be worth one per cent less to him than it would be in Philadelphia, where he had a demand for it. But, by the aid of the Bank of the United States, one-half of the expense of transporting specie is now saved to him. The bank, for one-half of one per cent, will give him a draft upon the mother bank at Philadelphia, with which he can draw either the bills of that bank or specie, at his pleasure. . . .

For all the purposes of the revenue, it gives to the national currency that perfect uniformity, that ideal perfection, to which a currency of gold and silver, in so extensive a country, could have no pretensions. A bill issued at Missouri is of equal value with specie at Boston, in payment of duties; and the same is true of all other places, however distant, where the bank issues bills, and the Government collects its revenue. When it is, moreover, considered that the bank performs, with the most scrupulous punctuality, the stipulation to transfer the funds of the Government to any point where they may be wanted, free of expense, it must be apparent that the Committee are correct to the very letter in stating that the bank has furnished, both to the Government and to the people, a currency of absolutely uniform value in all places, for all the purposes of paying the public contributions and disbursing the public revenue. And when it is recollected that the Government annually collects and disburses more than \$23,000,000, those who are at all familiar with the subject will at once perceive that bills, which are of absolutely uniform value for this vast operation, must be very nearly so for all the purposes of general commerce. . . .

But the salutary agency of the Bank of the United States, in furnishing a sound and uniform currency, is not confined to that portion of the currency which consists of its own bills. One of the most important purposes, which the bank was designed to accomplish, and which, it is confidently believed, no other human agency could have effected, under our federative system of government, was the enforcement of specie payments on the part of numerous local banks, deriving their charters from the several States, and whose paper, irredeemable in specie and illimitable in its quantity, constituted almost the entire currency of the country. Amid a combination of the greatest difficulties, the bank has at most completely succeeded in the performance of this arduous, delicate and painful duty. With exceptions too inconsiderable to merit notice, all the State

banks in the Union have resumed specie payment. Their bills, in the respective spheres of their circulation, are of equal value with gold and silver; while, for all the operations of commerce beyond that sphere, the bills or the checks of the Bank of the United States are even more valuable than specie. And even in the very few instances in which the paper of State banks is depreciated, those banks are winding up their concerns; and it may be safely said that no citizen of the Union is under the necessity of taking depreciated paper because a sound currency cannot be obtained. North Carolina is believed to be the only State where paper of the local banks is irredeemable in specie, and, consequently, depreciated. Even there the depreciation is only one or two per cent; and, what is more important, the paper of the Bank of the United States can be obtained by all those who desire it, and have an equivalent to give for it. . . .

The banks were, directly and indirectly, the creditors of the whole community; and the resumption of specie payments necessarily involved a general curtailment of discounts and withdrawal of credit, which would produce a general and distressing pressure upon the higher class of debtors. These constituted the largest portion of the population of all the States where specie payments were suspended, and bank issues excessive. Those, therefore, who controlled public opinion in the States where the depreciation of the local paper was greatest were interested in the perpetuation of the evil. Deep and deleterious, therefore, as the disease evidently was in many of the States, their legislatures could not have been expected to apply a remedy so painful as the compulsion of specie payments would have been without the aid of the Bank of the United States. And here it is worthy of special remark that, while that bank has compelled the local banks to resume specie payments, it has most materially contributed, by its direct aid and liberal arrangements, to enable them to do so, and that with the least possible embarrassment to themselves and distress to the community. If the State legislatures had been ever so anxious to compel the banks to resume specie payments, and the banks ever so willing to make the effort, the committee are decidedly of the opinion that they could not have done it, unaided by the Bank of the United States, without producing a degree of distress incomparably greater than has been actually experienced.—Report of Ways and Means Committee, April 13, 1830. "McDUFFIE'S Report."¹

The manner in which the bank checks the issues of the State banks is equally simple and obvious. It consists in receiving the notes of all those which are solvent, and requiring payment from time to time, without suffering the balance due by any to become too large. Those notes on hand, taking the average of the three and a half last years, amount always to about \$1,500,000; and the balances due by the banks in account current (deducting balances due to some) to about \$900,000. We think we may say that, on this operation, which requires particular attention and vigilance, and must be carried on with great firmness and due forbearance, depends almost exclusively the stability of the currency of the country.—Gallatin, *Considerations on the Currency and Banking System of the United States*. 1831.

BRANCHES AND THEIR RELATION TO THE CONVERTIBILITY OF THE CURRENCY.

The authority given to the directors to establish branches wherever they might see fit has been noted. The bank started with eighteen branches—the number being later increased to twenty-three. In accord-

¹ Clarke and Hall, p. 746, ff.

ance with the charter the notes issued by any branch were not required to be made payable elsewhere than at the office of that branch.

"The issues of the bank," says Mr. Catterall,¹ "were at their best in the first year of its existence. As the bank could not suspend specie payments and as its notes were receivable in all payments due the Government, the credit of these notes was excellent from the beginning. A third provision made convertibility complete. Each office of the bank received the notes of all the other offices at par. This was a most praiseworthy provision, and the results were excellent. As to-day everyone accepts a national bank note without caring to ascertain where it was issued, because such a note is receivable by all national banks at its face value, so at that time every one willingly accepted a note of the bank of the United States because wherever there was a branch of the bank the note would be redeemed at its face value. This general receivability by the Government and the bank led to the reception of the notes even by State banks in small towns and villages remote from a branch. Indeed these institutions considered such notes equal to specie, and even superior for the purpose of remittance.² Under these circumstances there could be no depreciation of the notes. Whether the bank issued them in New Orleans, Cincinnati, or Philadelphia was a matter of perfect indifference to the community.

"Unfortunately the business conditions existing in the United States were such that this excellent condition of the currency could not continue. The exchanges were always against the West, and almost always against the South in favor of the East. This being so, the notes issued by the branches in the South and West would inevitably be used to make remittances to the East. Impelled by the unfortunate results of this condition of affairs, the management decided in August, 1818, that the universal receivability of the notes should cease. According to the charter provision, notes not paid on Government account were redeemable only where issued. The bank now resolved that this should be the regulation henceforth, and immediate orders were given to that effect.³ The result was the impairment of the perfect convertibility which had existed hitherto. There were now eighteen distinct currencies of the Bank of the United States, and to a considerable extent the country lost one of the principal benefits sought in the establishment of the bank. The new regulation bore very grievously upon individuals, as one finds on reading Niles' comments upon his difficulties with the notes of distant branches practically irredeemable at Baltimore.

¹ *Journal of Political Economy*, September, 1897.

² Gouge, *Paper Money and Banking in the United States*, Part II, p. 206.

³ *State Papers on Finance*, p. 325. The offices were not to pay, or receive in payment of debt, or on deposit, any notes but their own.

"The want of complete convertibility in the bank's issues manifested itself in depreciation of the notes. This began with the order concluding their universal receivability, namely, in August, 1818, and lasted until the bank went out of existence. The depreciation was not always the same. In 1819, for instance, the bank restored the quality of universal redeemability in respect to its five-dollar notes. This, of course, affected the rate of depreciation materially. Later, the plan of receiving all notes at par in the city of Philadelphia was adopted. This again favorably affected the credit of the issues.

"Immediately after the order to cease receiving the notes of each branch indiscriminately at every branch, the notes were quoted at a discount. Exact figures are available only in the case of Philadelphia. On September 7, 1818, all branch notes were at a discount of 1 per cent in that city, and they remained at this rate of depreciation until March 1, 1819, when they were quoted at $\frac{3}{4}$ per cent discount. Leggett declares that on the 12th of April of this year the notes were at 10 per cent discount.¹ If this was so, it was a result of the panic, which was then at its height. The figures available for Philadelphia show no variation from the rate of $\frac{3}{4}$ per cent in March. In July the quotation was even more favorable, being $\frac{1}{2}$ per cent. At this figure they remained for the next four years. On March 3, 1823, the depreciation at Philadelphia was $\frac{1}{3}$ per cent and on the 2d of June in that year it was $\frac{1}{4}$ per cent. At this rate it remained until July, 1824, when all depreciation on small notes ceased so far as Philadelphia was concerned, and the depreciation on large notes expired with the year. The result must have been due to the policy now adopted of receiving all notes at par in Philadelphia.² The depreciation did not cease at any other place.

"The figures given for depreciation during this period are for the branch bank notes generally: The issues of some offices were at an even greater discount. This is true in regard to the notes issued at Boston, Middletown and Portsmouth. In September, 1820, these were at 4 per cent discount in Philadelphia; and at 2 per cent discount all through 1821, and until June, 1822.³ On the 4th of that month they were equal in value to other branch notes. Why the paper of these branches should have suffered greater depreciation than that of the others it is not possible to say.

"So much for Philadelphia. The recovery of the complete credit of branch notes after six years of depreciation was confined to that city.

¹ Leggett, Writings, Vol. I, p. 24, from the *Evening Post*, March, 1834.

² "Now Adopted." We learn from other sources that this policy was adopted, but the time is nowhere specified. It is only fair to argue that it must have been at this period, since it is only here that depreciation ceases.

³ Senate Document No. 457, pp. 17-25, XXV Congress, second session.

It was merely local. In the other towns and cities where the bank had branches the notes were still worth less than their face value. This was asserted by the enemies of the bank, and admitted by its friends. McDuffie, who defended the bank vigorously in his report of 1830, asserted that the notes of the branches were paid 'everywhere indiscriminately,' though he admits almost in the next breath that there were exceptions to the rule, and in his report says that the bank receives them 'frequently at par, and always at a discount' which was not in excess of $\frac{1}{2}$ per cent.

"President Biddle's testimony is to the same effect. He declared that all notes of five dollars were received indiscriminately at all the branches of the bank; notes of a larger denomination were not necessarily received, but usually were. All notes offered on account of Government were of course received. The particular branch issuing the notes paid them on demand, and so did the parent office at Philadelphia. It was impossible, however, for any 'human institution to pay all its engagements at any one time in twenty-five distant places.'

"Taney in 1833, while waging war against the Bank of the United States, procured evidence in regard to the partial irredeemability and depreciation of the notes. In answer to certain queries put by him, the following facts were established: At Baltimore, from 1820 to 1833, the branch had not received the paper of other branches from State banks, and the notes had consequently always been at a discount. This ceased with October, 1833, when the bank adopted the policy of receiving all its notes at par from State banks along the Atlantic coast. The state of affairs in New York was the same. The office refused branch notes from State banks and the notes were commonly depreciated $\frac{1}{8}$ per cent. Brokers of that city declared that for fifteen years they had traded in the notes of the branches of the bank.¹ They had bought these notes from State banks at a discount of from 1-7 to $\frac{1}{4}$ per cent, and had then sold at a smaller discount to merchants having duty bonds to pay. The latter parted with them to the Bank of the United States at par. This was true in respect to all but five-dollar notes, which were taken at their face value. Notes of other denominations were denominated 'uncurrent,' because they were not so received. Notes of the Bank of the United States were taken by the State banks from individuals on par, on deposit, or in payment of debt. At Mobile in Alabama the same conditions applied to the notes of the branches.²

"Nor was this all. It is certain that some branches sometimes refused to receive the notes of other branches even at a discount, a fact which

¹ That is, from 1818 to 1833.

² XXIII Congress, first session, Senate Document No. 24, p. 4. Letter from branch of Bank of the State of Alabama, November 4, 1833.

would make such paper, if far from its place of issue, virtually irredeemable. That branches sometimes refused to receive the paper of other offices is deducible from the instructions given them in this particular. Thus the cashier of the branch at Cincinnati is instructed by Cashier Jaudon, on October 3, 1832, that he is 'to judge how far it may be proper to refuse the notes of any other office' than his own. Similar instructions are found in letters to the cashiers of the branches at Lexington and Louisville.

"The conclusion which one is justified in deducing from the above facts may be summarized as follows:

"There was always depreciation after 1818. This depreciation, however, varied, being greater from 1818 to 1826 than it was later. Moreover, it was a depreciation due to the fact, not that the paper was irredeemable, but that it wandered far from its place of issue and redemption.

"So much as to the nature and fact of depreciation. When the amount of depreciation is considered it is found to be inconsiderable, ranging from 1 per cent in the early years to $\frac{1}{2}$ and $\frac{1}{8}$ per cent in the later years of the bank.¹ All notes, moreover, were redeemable at Philadelphia as well as at their place of issue; all notes of five dollars were receivable at par everywhere; frequently all notes of all denominations were received at all the offices from individuals, but not from banks; it was the notes held by State banks that were at a discount. Finally, all notes might be, and sometimes were, refused, except at the places where made payable."

BRANCH DRAFTS.

The Bank petitioned Congress in 1818 for an amendment to its charter allowing some other person than the president and cashier to sign the notes—the task having become a very burdensome one, with the growth of the bank's circulation. The desired authority, however, was not secured. The same petition was renewed in 1820 and 1823, but in neither case was action taken.

Failing again in 1826 to secure from Congress the relief sought, the Bank instituted a system of branch drafts. They were drafts drawn for \$5, \$10 and \$20 by a branch upon the parent bank. They were made payable to some officer of the branch, and upon his indorsing them they became payable to bearer and circulated as currency and performed precisely the same function as notes. They could, however, be prepared by the several branches and relieved the president and cashier of the bank at Philadelphia from the necessity of signing them. They

¹ Except in the case of the New England offices.

were used to a considerable extent in the years 1827 to 1836 and were regarded as a form of notes, and reported in the statements of notes in circulation.

In March, 1832, out of a total circulation of \$21,360,000, \$7,410,000 were these branch drafts.

The following table indicates the circulation of the several branches in September, 1819:

The total amount of bank and branch bank notes issued is.....			\$14,392,258.49
Of which there are on hand at the bank and branches.....		\$10,582,147.09	
In circulation as follows:			
Bank of the United States.....	\$864,716.40		
Offices, Portsmouth.....	103,530.00		
Boston.....	254,400.00		
Providence.....	38,295.00		
Middlebury.....	64,195.00		
New York.....	448,020.00		
Baltimore.....	331,620.00		
Washington.....	494,175.00		
Richmond.....	155,580.00		
Norfolk.....	69,390.00		
Payetteville.....	93,130.00		
Charleston.....	100,800.00		
Savannah.....	182,820.00		
Lexington.....	73,240.00		
Louisville.....	173,680.00		
Chillicothe.....	15,960.00		
Cincinnati.....	105,030.00		
New Orleans.....	174,760.00		
Pittsburgh.....	32,680.00		
		3,810,111.40	
			14,392,258.49

That there was some change in the relative importance of the branches will be seen by comparing the statement above given with a similar statement for September, 1830.

Actual circulation of the Bank of the United States in September, 1830, showing where the notes were payable.

Where Payable	Notes in Circulation	Where Payable	Notes in Circulation	Where Payable	Notes in Circulation
Bank of United States.....	\$1,367,180	Amount forward.....	\$4,116,050	Amount forward.....	\$10,982,940
Portland.....	79,280	Richmond.....	469,440	Nashville.....	1,235,275
Portsmouth.....	101,985	Norfolk.....	532,400	Louisville.....	662,375
Boston.....	271,180	Payetteville.....	713,760	Lexington.....	908,625
Providence.....	113,920	Charleston.....	835,840	Cincinnati.....	647,240
Hartford.....	171,532	Savannah.....	522,605	Pittsburgh.....	554,102
New York.....	834,733	Mobile.....	940,825	Buffalo.....	258,130
Baltimore.....	528,638	New Orleans.....	2,623,320	Burlington.....	96,595
Washington.....	647,602	St. Louis.....	228,700	Agencies, Cincinnati and Chillicothe..	2,375
	\$4,116,050		\$10,982,940		\$15,347,657

The following table, compiled by Mr. Catterall, shows clearly the great change from time to time in the seat of the bank's operations:

	Sept. 30, 1818	Sept. 27, 1819	Jan. 2, 1823	Dec., 1823	Sept., 1830	Jan. 1, 1832	April 4, 1832
New England States.....	\$518,415	\$368,336	\$393,257	\$401,077	\$737,897	\$741,587	\$900,867
Middle States....	909,780	1,082,869	868,060	1,085,205	3,110,740	5,525,403	5,478,378
Southern States...	3,900,550	1,179,132	2,281,765	1,728,810	4,250,285	4,950,265	5,311,370
Southwestern States.....	670,125	174,760	744,755	849,320	3,564,145	4,586,145	5,637,005
Western States...	817,680	249,528	45,820	16,785	3,684,590	5,445,030	5,130,990
New England and Middle States...	1,488,195	1,451,205	1,261,317	1,486,282	3,848,637	6,267,050	6,379,245
Southern, Southwestern and Western States.	5,448,355	1,603,420	3,072,340	3,444,235	11,499,020	14,981,440	16,079,365

"The distribution of the circulation is of interest as showing what parts of the Union were chiefly supplied by the bank with a currency. The figures, of course, do not show actually what amount of the bank's notes were circulating in the regions considered, but only what amounts had been issued by the branches in these sections. The information in respect to the distribution is not as complete as desirable, but there is sufficient to lead to some very certain conclusions.

"In the first place the New England States were not supplied with the bulk of their currency by the Bank of the United States. In September, 1818, the amount of the bank's notes issued in New England was a little less than one-thirteenth of the entire note circulation. It was small relatively to the whole amount issued, and it was small considered in itself. The sum was \$518,415. One year later it was much less, but relatively to the entire circulation it was a little in excess of one-ninth of the whole. In January, 1823, the proportion was about one-eleventh, and in December of this year it was one-tenth. The issues in New England had not increased to any appreciable extent, either relatively or absolutely, since 1818. They were less in December, 1823, than in September, 1818. By September, 1830, the total had materially increased, but not to anything like the extent that the entire note circulation had. At that time it amounted to only one-twentieth of the sum of the bank's issues. By January, 1832, the New England issues were about what they had been in 1830, and were only one twenty-ninth part of the whole. This condition of affairs was not materially altered in April, 1832.

"It is evident, therefore, that New England was largely outside the sphere of the bank's circulation. It never was a favorite field for the operations of the institution, and it grew less so as time passed. Undoubtedly this was largely due to the excellent system of State banks in operation throughout New England. There was little need and less profit for a National bank in these States, and, therefore,

the bank paid greater attention to other and more lucrative fields of business.

"In the Middle States the issues were more extensive. Yet even here they were not so large as might naturally be expected. In September, 1818, not one dollar in seven was issued in this part of the Union. A year later the proportion was more favorable, being about one in three. This result was due to the contraction of 1818-19 which materially limited the southern and western issues. After this time the officers in the Middle States never issued so large a proportion of the note circulation. In 1823 it was from one-fourth to one-fifth of the whole. In 1830 it was still the same, and in 1832 it had not increased to any marked degree. Considered in themselves the sums show an increase, of course. From about a million in the earlier years they increased by 1830 to three times, and by 1832 to five times that sum. On the whole, however, the particular field of the bank's issues was not here. Considering how extended commercial operations were in both the Middle and New England States the amount of the issues in these sections was surprisingly small.

"The truth is, that the legitimate sphere of the bank's operation was always considered to be rather in the South and West than in the East and North, and the figures show that this was the case in respect to its issues. In September, 1818, over half of them were made in the South, meaning by "the South" the branches of the bank located in those of the thirteen original States south of Mason and Dixon's line. A year later, after the contraction of 1818-19, the proportion here was a little less than one-third of the whole, and the total, considered absolutely, had fallen off in a remarkable manner, showing that the issues in 1818 had been in all probability redundant. In January, 1823, they were again over one-half of the total issues, but did not reach nearly so high a figure as in 1818. In 1830 the proportion exceeded one-fourth, but the absolute amount of the issues was greater than ever before. There is a further large increase in 1832, but the proportion remained about the same.

"These facts show that the South was in the beginning the principal field of the bank's operations, and that it remained until the end a very important one. The reason for its smaller relative importance at a later date is to be found in the great extension of the bank's dealings in the Southwest and West. As regards these sections we have a slightly different course of affairs. The Southwest was represented in the early years of the institution by the great office at New Orleans. This branch, in the amount of its business, easily ranked third. Its issues were very extended and usually exceeded the sum of all those made in New England. But it was not until after 1827 that the Southwest became an

especially important territory for the bank's issues. In September, 1830, the total of the note issues was only a little over a half million less than that of the southern offices. In 1832 the same continued to be the case, the offices of New Orleans, Mobile and Natchez issuing a full fourth of all the notes emitted.

"In the West, strictly speaking, at the Kentucky, Tennessee and Ohio branches, the issues followed about the same course as in the Southwest. In September, 1818, they aggregated about one-eighth of the whole, being almost equal to the sum of the issues in the middle States. In proportion to the population and commercial interests of these new States this circulation was enormous. It was in respect to the West, therefore, that the most energetic efforts were made to restrict the circulation. In September, 1819, the total was not one-third that of the year previous, and in proportion to the entire note circulation was less than one-fifteenth of the whole. By January, 1823, the effect of Cheves' policy of almost total restriction is clearly perceived. At that date the active Western offices issued only \$45,820, and in December of the same year only \$16,785—insignificant sums which hardly permit one to speak of Western issues. Again the change takes place after 1827, after the invention of branch drafts and the new plan of extensive operations in exchange. The change is indeed a remarkable one. In September, 1830, the issues are over 3.6 million dollars, an amount in excess of that issued in the middle States, and almost equal to the sum of those of the Middle and New England States taken altogether. The proportion is a little less than one-fourth of the whole, and this proportion is retained in 1832; which year shows a great increase in the issues of the West, the amount being over five million dollars.

"From this analysis it is seen that the South was for one-half the bank's existence the principal field for the note issues. After 1827 the West and Southwest rise to about equal importance. Taking Southwest and West together their total issues equal about one-half of the whole. Taking South, Southwest and West together, in comparison with the New England and the Middle States, we find that in September, 1818, these sections had almost four times as great a note circulation; in September, 1819, it was a little over that of the East and North; in 1823 it was 2.4 times greater; in September, 1830, it was three times greater. and had increased from 3.4 million dollars in 1823 to 11.4 million dollars. In 1832 the proportion was not so great, though the increase since 1830 was larger than during any other two years of the bank's history.

"There were, of course, many excellent reasons for this state of affairs, but the principal reasons can be given in one sentence: Banking operations in these regions were more profitable than elsewhere, and the

demand for note issues was greater. But at the bottom of these facts lay a serious danger to the bank. It will not escape notice that at the periods of great expansion, which were also periods of embarrassment to the Bank of the United States, the expansion of the currency in these sections was especially noteworthy. In the first years of the bank this was particularly true of the southern and western issues, while later it is more applicable to those of the West and Southwest. The two periods of greatest expansion are marked by the years 1818 and 1832. That of 1818 was due to Jones' policy of permitting the offices to emit their notes without any adequate restrictions."¹

HOSTILITY OF STATE BANKS.

The bank had incurred the hostility of the State banks in many sections, especially in the South and West, by compelling them to redeem their notes.

"The word 'Monster,' which later became such an effective catchword in the bank war," says Mr. White, "was first applied to the bank in Kentucky because it would not allow the notes of the local banks to accumulate as deposits in its branches without redemption. . . .

"The same frenzy existed in Ohio as in Kentucky. Branches had been established at Chillicothe and Cincinnati. An attempt was made to drive them out of the State by taxing each of them \$50,000 per annum. They refused to pay and appealed to the courts. The State officers broke open their vaults and carried off more than the amount of the tax, and lodged it in the State treasury at Columbus. What followed is thus described by Professor McMaster:

For this act the auditor, his agents, and the State treasurer were sued by the bank, and while the suits were still pending the legislature assembled and began an investigation. The times were now hard indeed. All the fine visions of the speculators, the paper-money men, the bank men had vanished. Bankruptcy and debt were everywhere. Stay laws, replevin laws, indorsement laws, relief laws of every sort were the order of the day. Nothing was so hateful now as a bank, and above all the Bank of the United States. The Supreme Court had decided that a State could not tax it. But Ohio adopted and affirmed the Virginia and Kentucky resolutions of 1798 and 1800; hurled a defiance at the Supreme Court, told it that acquiescence was not the necessary consequence of its decisions, and passed "An Act to withdraw from the Bank of the United States the protection of the laws of this State in certain cases." If the bank gave notice to the Governor of its willingness to stop the suits against the State officers, and to submit to a four-per cent tax on its dividends, or leave the State, the Governor might suspend the law by proclamation. If it did not, then every jailor was forbidden to receive into his custody any person committed at the suit of the bank, or for any injury done to it. Every judicial officer was prohibited from taking acknowledgment of conveyances when the bank was a

¹ Catterall, pp. 431-435.

party, and every recorder from receiving and entering them. Notaries public were prevented from protesting bills or notes held by the bank and made payable to it; and justices of the peace, judges, and grand juries could no longer take cognizance of any wrong committed on the property of the bank, though it were burglary, robbery, or arson. The bank would not discontinue the suits, nor leave the State, so the law went into effect, and in September, 1820, the Bank of the United States became an outlaw in Ohio.

"The State of Georgia," continues Mr. White, "had a wholesome law, passed in 1816, providing that if any bank should refuse to pay its notes in specie on demand it should pay interest at the rate of 25 per cent per annum on the default.

"When the Bank of the United States established its branch in Savannah it received the notes of the Georgia banks at par. In the year 1820 it began to make demands on them for the redemption of such notes. They refused to pay, although they pretended to be solvent. They refused also to allow interest on the unliquidated claim. They prevailed on the Legislature in May, 1821, to repeal the 25 per cent penalty on the ground that it was only 'in the interest of brokers and lottery ticket sellers.' This left the bank liable to 8 per cent interest on the default, that being the legal rate on all deferred claims. This did not suit them. So they procured the appointment of a joint committee of the Legislature to report on the incendiary action of the United States Bank. This committee reported in November, 1821, that the Bank of United States, having been intruded upon the State of Georgia without her consent, was an interference with her sovereignty as an independent State. They said that by accumulating notes of State banks it had deprived the State of a circulating medium, and by frequent and repeated demands of large sums of specie had compelled them to curtail discounts and 'to deprive the State and the individual stockholders of their usual and expected dividends.' They recommended a law establishing a rate of interest between the United States Bank and the State banks so low as to prevent all of said banks from being benefited by accumulating each other's notes; that while the State banks should continue to pay individuals in specie 'they shall refuse whenever they think it prudent to do so, to pay specie for their bills to the United States Bank or its officers or agents, upon giving 60 days' previous notice of such intention.'

"In order to make a complete job of it, the Legislature decided to fix the rate of interest at zero. On the 24th of December, 1821, it passed an act virtually authorizing solvent debtors to refuse payment to one creditor but not to others, thus:

SEC. 4. That if the Bank of the United States or either of the branches of said bank, shall, after the first day of January next, collect, acquire, purchase or receive on deposit the bills or notes of either of the banks incorporated by the

State of Georgia, which have been or may hereafter be issued by the banks aforesaid, and shall demand specie for the same, the bills or notes, so collected by the Bank of United States, or either of its branches, shall not bear interest on account of any refusal by either of the banks incorporated in the State to redeem the same in specie.

SEC. 5. Nothing in this act shall be so construed as to deprive individuals who may demand specie for themselves for the notes or bills of either of the banks incorporated by the General Assembly of this State, from the same privileges and advantages in obtaining specie or interest as now exist by the laws of this State.

Gouge says that after this law was passed the Bank of the United States sold its Georgia bank notes at auction on the Savannah Exchange.

The Suffolk System.

Adapted from an Article by L. Carroll Root in "Sound Currency Reform Club," 1895, pp. 276-281.

The most interesting feature about the banking experience in New England was the system of bank-note redemption which was there developed—a system which not only had a vast influence in consolidating all the New England banks, without regard to the individual States by which they were chartered, into one single banking system, with its center at Boston, but contributed more than almost any other agency to the remarkable success of its currency in the essential matters of safety, convertibility and elasticity.

"The business man of to-day," says Mr. D. R. Whitney, in his admirable history of the Suffolk Bank, "knows little by experience of the inconvenience and loss suffered by the merchant of sixty years ago arising from the currency in which debts were then paid. . . . The merchant of 1818, receiving payment in bank notes, assorted them into two parcels, current and uncurrent. In the first he placed the notes issued by the solvent banks of his own city, in the other the bills of all other banks. Upon these latter there was a discount, varying in amount according to the location and the credit of the bank issuing them. How great the discount was he could learn only by consulting the "Bank Note Reporter," or by inquiring at the nearest exchange office; and he could avail himself of them only by selling them to a dealer in uncurrent money. He could neither deposit them nor use them in payment of his notes at a bank. The discount on them varied from one per cent upward, according to the distance the bills had to be sent for redemption and the financial standing of the bank by which they were issued. Many banks were established in remote places mainly for the purpose of making a profit on circulation. The more distant they were from the business centers the more expensive it was to send their bills home for redemp-

tion, and the more difficult it was for the general public to know their true financial condition."

Even earlier than the period of which mention is here made the condition was less settled, but no more satisfactory. For a few years, while the only notes in circulation were those payable in Boston, they were preferred to specie both in town and country; but as soon as notes issued by banks some distance removed came into circulation, the question arose whether or not they should be received by the Boston banks at par. The practice was fluctuating, sometimes at par and sometimes at a small discount. The country banks, sustained by public opinion, protested against those of Boston sending home their bills for redemption; and finally, in 1796, the Boston banks gave up receiving them altogether.¹ The result was that the bills of the country banks filled almost exclusively the channels of circulation, even in Boston, and thus was a double currency introduced—"foreign" or "current" money, and "Boston" money. At this time, of course, means of communication were slow and inadequate; and the rapid spread of banking in 1803 and 1804 had resulted in the incorporation of what at that time must have seemed a multitude of banks, of the condition of which little could be ascertained. In 1804 an institution was established called the "Boston Exchange Office," the object of which seems to have been to extend and equalize the circulation of foreign bank notes, in which currency it received deposits, collected notes and made discounts.² This seems to have been the first attempt at anything beyond individual action in dealing with the problem. The experience, however, was not satisfactory and the bills of the banks more readily accessible continued to be sent home for specie, and the discount on the rest increased to four or five per cent.

¹ In this connection, it may be noted that the early records of Connecticut show that the Union Bank of New London, the second bank in the State, began a practice of sending specie to Boston to redeem their bills in the hands of one of the banks there. That this was quite exceptional, however, is evident from the fact that in April, 1796, a letter was received from an officer of the Union Bank in Boston in which he said that the banks of that city had experienced so much inconvenience from the increase of foreign bills that they had agreed not to receive the bills of any bank out of Boston, and that they regretted extremely being obliged to apply the rule to the case of the Union Bank of New London, for if the other banks had been as attentive to the redeeming of their bills as that bank no such regulation would have been necessary. A correspondence ensued which resulted in the appointment of this officer of the Union Bank in Boston as the agent for the redemption of the notes of the bank at Boston, he being furnished with funds in advance for that purpose. No evidence is at hand that any other bank made similar provision for their bills.

² "The said corporation shall have liberty to establish and keep in Boston a fund of \$50,000 in current bank bills of this Commonwealth and a further sum in specie of \$50,000. . . . The said corporation shall neither directly nor indirectly run upon, or make a demand for specie on any of the incorporated banks of this Commonwealth, or which may hereafter be incorporated, which may cause distress; nor knowingly furnish any person or persons with bills for that purpose; and in order that an impartial currency may be given to the bills of this Commonwealth, said bills shall at all times be paid out promiscuously, as they are received; and the said corporation is hereby restricted from asking or receiving a premium for exchanging the bills of one bank aforesaid, for those of any other of this Commonwealth, or for specie, or to purchase the bills of any bank of this Commonwealth at a discount, during its continuance."—Act of June 23, 1804.

This institution was subject to some of the restrictions of the banks of the State, and might discount to the amount of one-third the specie and bills on deposit; but could issue no notes of its own.

Nothing further is heard of the Boston Exchange Office, and in 1808 the merchants and dealers of the City, having found the existing condition of the currency injurious to their business interests, raised a fund for the purpose of sending home bills received in business and enforcing their redemption. This move, however, was too sudden, and the failure of several banks which had issued notes without much preparation for their redemption was the result.

The year 1813 was marked by an important movement toward reforming the condition of the bank-note currency in this regard, through the agency of the New England Bank, which commenced operations October 5 of that year. The condition of the local currency of Boston was, at this time, in the main satisfactory; but the notes of banks in New York and all the New England States—many of them of doubtful solvency—were spread broadcast over the country and found ready acceptance even at Boston, where they almost monopolized the field. Scarcely a dollar of Boston paper could be seen. The reason was not far to seek. The notes of foreign banks—so long as they were known to be solvent—passed readily from hand to hand in ordinary business transactions, but at the banks they were not accepted. Persons having payments to make at the bank therefore found it advisable to lay aside any notes of Boston banks which might come into their hands, as such notes and specie were the only forms of currency accepted at par by the banks, while foreign notes, which were readily accepted in business, were paid out again and thus kept in circulation. The ordinary method of procedure when the holder of any of these foreign bills wished either to make a payment at a bank or to procure specie was, instead of sending them to the issuing banks for redemption in specie, to exchange them at a discount with some one in Boston who would give him Boston money.

This discount in 1813 was much greater than the actual expense and losses incurred would justify, and to its reduction the New England Bank set itself. It immediately gave notice that it would charge those who wished to avail themselves of such an arrangement only the actual cost of sending foreign money home to the issuing bank and obtaining specie for it. The result was that the rates of discount, both on bills of Massachusetts banks out of Boston and on those of reasonably sound basis in other States, were very materially lessened.

This, however, subjected foreign banks to the necessity of being prepared for more prompt and certain redemption than they had been obliged to make preparation for, and some of them opposed it vigorously.¹

¹ In 1814 three wagon loads of specie being transported from New York to Boston by the New England Bank were seized at Chester by the Collector of New York on the pretext that it was the intention of the New England Bank to send the money to Canada; the real reason

The Suffolk Bank System.

The system inaugurated by the New England Bank did not do away with the discount in Boston upon foreign notes. It merely brought it down to more nearly the actual cost; and instead of four per cent or five per cent, the usual rate in the years 1814-18 was about one per cent for notes of Massachusetts banks, and somewhat more for those of other States.

In 1818 the Suffolk Bank was incorporated and went into operation in Boston. Almost immediately the directors turned their attention to foreign exchange, and in 1819, seeing that they might add to the profits of the bank by buying country bank notes at a discount and sending them home for redemption, they determined to give special attention to that branch. The committee by which the matter had been considered had reported:

"That it is expedient to receive at the Suffolk Bank the several kinds of foreign money that are now received at the New England Bank, and at the same rates. That if any bank will deposit with the Suffolk Bank \$5,000 as a permanent deposit, with such further sums as shall be sufficient from time to time to redeem its bills taken by this bank, such bank shall have the privilege of receiving its own bills at the same discount at which they are purchased." They further recommended "that the banks located in Providence and Newport," and twenty-three other banks then keeping an account with the Suffolk, "shall have the privilege of receiving such of their bills as may be received by the Suffolk Bank at the same discount as taken, without the permanent deposit of \$5,000, provided said banks will make *all* their deposits at the Suffolk Bank, and at all times have money sufficient to redeem the bills taken." Also, "That should any bank refuse to make the deposit required, the bills of such bank shall be sent home for payment at such times and in such manner as the directors may hereafter order and direct." The president was also authorized to compound with any bank not to purchase its bills.

The result of the hearty action of the Suffolk Bank, in accordance with this report of its committee, was a lively competition with the New England Bank, which soon brought the rate of discount on Massachusetts bills down to one-half of one per cent, or even less. But even this, though so much less than in earlier years, still operated as a premium to keep the bills of the country banks in circulation, in preference to funds which could be used at par in payments of the Boston banks.

A committee of the directors of the Suffolk Bank, April 10, 1824,

for the seizure was obviously enough the hostility of the New York banks to the redemption program of the New England. The restoration of the specie was secured through a petition of the Massachusetts Legislature to the President.

laying before the other banks of Boston their plans for checking the enormous issues of the country banks, especially those of Maine, called attention to the fact that the 11 banks of Boston possessed a capital of \$11,150,000 out of a total for all New England of less than \$20,000,000; yet that the country banks furnished \$7,500,000 of the circulating medium, while the banks of the city, with a capital more than equal to all the rest, kept in what might be fairly termed permanent circulation only \$300,000. They stated that in less than three months the Suffolk Bank had received nearly \$1,000,000 in country paper, the greater part of which had been sent home for collection or redeemed by agents in Boston. As the benefits proposed—an increased circulation and discounts—would be common to all the banks of the city, this committee proposed a co-operation of all the city banks in measures by which, if vigorously pursued, the banks might obtain a circulation of \$3,000,000 and a proportionate increase in their deposits.

The result was an agreement between the Suffolk and six other Boston banks under which a fund of \$300,000 was furnished in the notes of the several banks in the following proportions: State Bank, \$50,000; Massachusetts Bank, \$50,000; Union Bank, \$40,000; Manufacturers and Mechanics' Bank, \$40,000; Columbian Bank, \$30,000; Eagle Bank, \$30,000; Suffolk Bank, \$60,000.

These bills were placed in the hands of the Suffolk Bank, which was to pay them out in equal proportions in purchase of country bank notes. To carry out the scheme it was agreed that the Suffolk Bank should receive from the other associated banks all their foreign money at the same or less rate of discount than the New England Bank, or other banks in Boston, received it, and should send it home for redemption, unless the issuing banks should make satisfactory provision for its redemption in Boston. May 24, 1824, the Suffolk Bank began business under this agreement which might be terminated by either party on 30 days' notice.

The animosity previously shown by the country banks against the Suffolk Bank while acting independently was redoubled as they began to appreciate the curtailment of their circulation that would result, and felt the necessity of keeping larger specie reserves. The association was termed the "Holy Alliance" and the Suffolk Bank derided as the "Six-Tailed Bashaw."

After a year's experience with the arrangement outlined, the Suffolk Bank agreed to receive from the associated banks *at par*, instead of at the minimum discount current, all the country money they might receive from their depositors, and immediately place it to the credit of the depositing bank.

The general arrangement made between the Suffolk Bank and the

New England banks which opened an account with it, for the redemption of their bills, was as follows: Each bank placed with the Suffolk a permanent deposit of \$2,000 and upward, free of interest, the amount depending upon the capital and business of the bank. In consideration of this deposit the Suffolk Bank redeemed all the bills of that bank which might come to it from any source, charging the redeemed bills to the issuing bank once a week, or whenever they amounted to a certain fixed sum; *provided*, the bank kept a sufficient amount of funds to its credit, independent of the permanent deposit, to redeem all of its bills which might come into the possession of the Suffolk Bank; the latter bank charging it interest whenever the amount redeemed should exceed the funds to its credit; and if at any time the excess should be greater than the permanent deposit, the Suffolk Bank reserved the right of sending home the bills for specie redemption. In payment the Suffolk Bank received from any of the New England banks which kept an account with it the bills of any New England bank in good standing, at par, placing them to the credit of the bank sending them on the day following their receipt.

"The effect of the measure, partially adopted by a few banks, was such that the circulation of 16 banks in Massachusetts, in six months' time, decreased \$382,371; one of them from \$213,566 to \$117,143, an enormous amount still for one bank, located in a small town. In Maine the decrease was \$336,819 in six months; while in the same time the circulation of the Boston banks increased \$283,497."¹

This increase of the circulation of the Boston banks (which were, of course, the institutions with largest capitals) coupled with the decrease in the circulation of the smaller banks of the State, favorably broadened and strengthened the general basis of the circulation. The amount of notes outstanding issued by the Boston banks was in 1826 about twice as large as four years previous, while those of the distant banks had decreased nearly 25 per cent.

When any bank refused to join in the "Suffolk System," the Suffolk Bank simply *presented its notes for payment* at its counter. Now, as those notes were issued on the express condition that they should be redeemed on presentation, this proceeding on the part of the Suffolk Bank, however disagreeable to its debtors, can hardly be called unjust or oppressive. It had, moreover, the desired effect of convincing the greater part of the country banks that it was far easier and cheaper to collect and pay their debts in Boston than to continue under the manifold evils of the old system, aggravated by the improved condition of their neighbors; for, as every part of New England has pecuniary

¹ *Report of Committee on Banks, Rhode Island, 1826.*

transactions with Boston, all the bank notes which were redeemed at Boston were naturally at par in every part of New England.¹

Although the hostility to the Suffolk Bank somewhat abated as the system became more widely extended and more and more country banks opened an account with it, still many of the weak ones always felt that it was arbitrary and oppressive.²

From the following letter, written in 1832 by the cashier of the Suffolk Bank to the Bank of Rutland, Vt., something of an idea may be obtained of the feeling then prevailing, and of the actual position of the Suffolk Bank with regard to the New England banks. It also clearly states one of the principal reasons for requiring them to keep a permanent deposit. He writes:

We have never required you to redeem your bills at this bank instead of your own; nor have we ever demanded of you "an exorbitant price for counting your bills." They will be received and counted at this bank whether you have a permanent deposit with us or not. We ask of you a permanent deposit as a consideration of receiving from you bills of all the other banks in the New England States in exchange for your own at par; some of which are converted into specie by us at a discount of one and a half per cent. In addition, we take the whole risk of those bills after they have been placed in our hands. . . . If you still think the price we ask for transacting your business is exorbitant, and should prefer paying your bills at your own counter, we have no objections to sending them there; but we hope you will not expect us to take the bills of all the other banks in the New England States in payment for them at par. We have no intimation from other sources of a growing dissatisfaction among the country banks; and if we had, we should not feel ourselves obliged to transact their business without a reasonable compensation. On the contrary, gentlemen who were very much opposed to the system we have pursued at its commencement now express approbation of it, and their willingness to contribute to its support rather than that it should be abandoned.

Occasionally, however, a bank would cut loose from the arrangement, in the hopes of getting up an increased circulation. Finding, however, that their circulation was then limited to their immediate vicinity, they were usually glad to return to the usual arrangement.

The banks of Maine, especially, for many years bitterly opposed the system, and there was never a time when there was not some opposition

¹ J. S. Roper in *Hunt's Magazine*, vol. 24, p. 707.

² One of the most strenuous opponents of the Suffolk Bank system was the Veazie Bank of Bangor. Through its instrumentality a law was passed in Maine giving the banks of that State a certain delay, after demand at their counters, in which to redeem their bills in specie. The Veazie Bank availed itself of the time allowed, which it used to the annoyance of the Suffolk Bank. Having received in the regular course of its business a quantity of Veazie Bank notes, the Suffolk Bank would send a messenger to Bangor and demand specie for the same. The bank would acknowledge the demand and claim the lawful delay. In the meantime, it would collect Boston funds and send them to a well-known Boston broker, who, himself no friend of the Suffolk Bank, would take great pleasure in exchanging them in one way or another for checks on that bank. He would then present himself at the bank, demand specie for his checks, and with the coin thus obtained pay it for the bills for which it had demanded specie some days before; in short, not only requiring the Suffolk Bank to hold the bills of the Veazie Bank for a certain specified time, but at the end of that time to furnish specie for their redemption.—D. R. WHITNEY, *The Suffolk Bank*.

from one or more of the Maine banks—sometimes with the full approval of the State officials, as is evident from the following:

The two banks at Bangor deserve particular commendation. These banks formerly complied with the requisition of the Suffolk Bank, for the privilege of redeeming their bills in Boston with current money; but that bank having, as the directors say, violated that arrangement between them, they withdrew their deposits and have for several months redeemed their bills with specie only, and at their own counters.

They have, as will be seen by the abstract, a liberal supply of specie in proportion to their bills in circulation, and are entitled to the unlimited confidence of the community. The Boston alliance, as was to be expected, have constantly sent home their bills for specie, but all calls have thus far, and will, we doubt not, continue to be promptly met. Former attempts to resist this alliance, formed for the purpose of controlling the pecuniary resources of New England, have proved unsuccessful; nor is it probable that two or three banks can now contend against it with any prospect of success. Whether the present system of paying tribute to Boston is susceptible of improvement, or how far it is consistent with the interest and honor of the State, or whether the evils which result from its operation are of sufficient importance to call for legislative action, are questions which we shall not undertake to decide.—*Report of Maine Bank Commissioners, 1837.*

That these sentiments were not long regarded as expressive of the true situation is evidenced by the following quotations from subsequent reports:

Our banks have accomplished their great object, of furnishing a sound currency—sound, equal and uniform, in consequence of its redemption at par in the great central market of the country. The bills furnish a most convenient instrument for exchanging the various commodities of commerce and agriculture, and go into wide circulation. . . . The system is admirable, and is, perhaps, without a parallel in the world; it leaves us nothing to desire, so far as an instrument of commerce is needed within the circle of the Eastern States.—*Report of Maine Bank Commissioners, 1842, p. 11.*

All the banks now in operation redeem their circulation in Boston, except three: The Calais Bank at Calais, the Mercantile Bank at Bangor, and the Westbrook Bank at Westbrook. These three banks, the public will perhaps be surprised to learn, are sound and well-managed institutions, and perform all their legal obligations to their bill holders. They pay their bills on presentation at their own counters, where alone, by law, they are bound to pay them. And their bills pass as cash in the immediate vicinity of the banks, although they do not even there answer all the purposes of money, as they cannot be sent abroad without loss; and if they chance to stray beyond a small and limited circle, or if wanted for foreign purposes, embarrassment and loss to the holder is the result, irritation and loss of confidence takes place not only in these banks, but to some extent in all.

Boston being the great business mart for New England, all money which is not current in business there cannot be said to answer all the purposes of money. . . . The suggestion is therefore made, whether, under existing circumstances, there is not a moral obligation resting upon the directors of those banks to make their bills current in Boston.

The Suffolk system, so called, has been believed by some to be tyrannical and

oppressive, adopted by the strong to compel those to pay tribute whom circumstances had placed in their power. But when it is considered that this system was merely to receive the bills of the country banks as cash, and present them at their own counters for payment, and that any other arrangement than this was a mutual bargain for mutual benefit and convenience, it is difficult to perceive in what consists the wrong. And it is believed that this system, and this system alone, in times gone by, has preserved our moneyed institutions from the general wreck which has fallen upon those of some of our sister States.—*Report of Maine Bank Commissioners*, Dec. 31, 1842.

The notes of the three banks above mentioned were at this time quoted in the weekly price currents at a discount of from one to eight per cent.

Again, speaking of the Calais Bank and the Mercantile Bank, in 1848, the Commissioners said:

"Their bills will not circulate beyond a limited sphere. At fifty miles distance they cannot be used without loss, while the bills of the other banks of the State circulate, it is said, without loss to the farthest bounds of the Union."

In general, it was the practice of each bank to gather together the bills of all other banks paid in over its counters and include them in its weekly remittances to the Suffolk Bank for the purpose of meeting the redemption of its own bills. In Rhode Island this practice was so far modified by the arrangement between the Merchants' Bank and the other banks of the State that each was allowed to include the notes only of banks in other towns than that in which it was located. This was far from general elsewhere, however; and the Bank Commissioners of Maine note, in 1840, that though some banks near each other exchange bills many send those of their immediate neighbors away to the Suffolk, and in this practice the Commissioners found another objection to the "condemned system," which thus "makes banks of necessity compete to do each other injury by preventing a circulation of their respective bills."

Between the years 1831 and 1833 a great increase took place in the number of banks in New England. During this period no less than ninety new banks were chartered. By 1834 the redemption business of the Suffolk Bank had increased fivefold, from \$80,000 to \$400,000 daily. To reduce the business, it became necessary to modify somewhat the arrangement made with the Boston banks. Theretofore they had been allowed to send in *all* their foreign money at par. Now they might send in on any one day an amount equal to one-half their permanent deposit only. If they exceeded that amount they were charged one-tenth of one per cent on the excess. They were also restricted to the foreign money received by them in their regular course of business, excluding deposits from banks and brokers. At the same time the permanent deposits of the Boston banks were reduced to \$10,000 and a year after to \$5,000.

In Rhode Island there was early inaugurated a subsystem of redemption on practically the same basis as the central system. It is thus explained by the Committee on Banks in 1836:

"An arrangement exists between the Merchants' Bank in Providence and all but four of the banks in this State (except the Providence banks) to redeem their bills. The four banks not included in the arrangement are the Cranston, Kent, Village and Fall River Union Banks. The permanent deposits of the banks in the Merchants' Bank vary from \$1,000 to \$3,000 each. The whole amount of deposits is about \$60,000. . . . The Merchants' Bank receives at par from the banks with which it has an arrangement the bills of all other banks in New England, except of those in the same town where the bank is situated. Where the balance is against a bank upon the amount of bills collected, and the permanent deposit would be thus trenced upon, interest is charged. The interest accounts are closed and the balances carried forward once a month.

"An arrangement also exists between the Merchants' Bank and the Suffolk Bank in Boston, as follows: The former receives at par from the latter all the bills of banks in this State except the four above mentioned. It remits at par bills of all the banks in the New England States except Rhode Island. The Merchants' Bank pays interest on any balance against it; the Suffolk Bank pays none. This arrangement is the basis of that with the other banks, as before stated."

By virtue of this arrangement the Suffolk Bank was relieved from the necessity of keeping accounts and doing business with all the Rhode Island banks. Yet their redemptions were meanwhile carried on just as satisfactorily through the medium of the Merchants' Bank as they could have been had each of the Rhode Island banks dealt directly with the Suffolk. When the simplification thus effected is considered, the strange thing is not that the Rhode Island banks should have preferred to do business in this way, but that other States did not have similar subsystems.

The suspension of specie payments in 1837 put an end at once to all coercive measures on the part of the Suffolk Bank, and consequently each bank was left to its own volition. Many of them continued to redeem their bills at the Suffolk as they had done in the past. The bills of these banks, according to Mr. Whitney, passed current all over the Union, and in some places even commanded a premium. Other banks withdrew their accounts and the bills of those banks had a local circulation only. At first many of the weak banks, particularly those of Maine, which had always been opposed to the Suffolk were inclined to break off, and even some of the stronger ones were ready to abandon

the system entirely. The most of them were held together, however, and at the resumption of specie payments the Suffolk Bank was able to take its old place at the head of the redemption system.

As to the internal organization of the Suffolk Bank throughout practically the whole period of its existence as a center of redemption, it may be noticed that the practice was early inaugurated, and thereafter adhered to, of paying a sufficient salary to the head of the Foreign Money department to cover all expenses connected therewith—he hiring his own clerks and assuming all loss by counterfeits and uncurrent or mutilated bills. The salary was from time to time increased as the business grew, until from \$4,250 in 1826 it had risen to \$8,500 in 1837; \$10,800 in 1846; \$20,000 in 1849; \$24,000 in 1853; \$30,000 in 1854; and \$40,000 in 1857.

The total expenses incurred by the bank in carrying on its foreign money work for the year 1858 was \$40,000—the largest amount ever appropriated for the purpose. The redemptions during this year amounted to \$400,000,000. In other words, the business was carried on at an expense of only 10 cents per \$1,000. It is interesting to compare with this the results of our present system of redemption of National Bank notes. In the fiscal year 1894 the total amount of such notes passing through the redemption agency in the Treasury Department at Washington was \$101,767,455, of which \$50,944,080 were soiled and mutilated notes returned for destruction and reissue, \$10,929,535 more were in final redemption of notes of banks not longer issuing circulation, and only \$39,893,840 normal current redemption. This redemption was carried on at a cost of \$107,445—or \$1.06 per \$1,000.

When it is remembered that it is only through constant working of an effective system of redemption that elasticity can be secured and every tendency to expansion in excess of the demands of commerce promptly checked, the importance of this showing cannot be too strongly emphasized. In New England at this time the circulation of the banks for which redemption was carried on was less than \$40,000,000. The whole circulation was, therefore, on an average, redeemed ten times over during the year.¹ At the present time an amount equal to the entire circulation of the National banks does not pass through the redemption agency in less than two years, even at the rate of last year's

¹ On this point, a committee appointed to examine the banks of Connecticut in 1837 reported that they "have taken pains to inquire at each bank the average period of the circulation of their bills, and find, that so rapidly do their bills circulate and return for redemption, that for the six months prior to the 1st of April last about two-thirds of the bills of the Connecticut banks in circulation were redeemed once in thirty days and the other third within about forty-five days from the time they were issued."

So, too, in 1841, the Bank Commissioners of Maine stated that the average circulation of the Central Bank of that State for the preceding six months had been \$48,000, and the average monthly redemption of its notes in Boston during the same period \$38,000.

redemptions, which were far larger in proportion to the circulation of the banks than at any other time for the past fifteen years.

The following table shows the amount of notes of New England banks annually redeemed through the Suffolk Bank:

DATE	REDEMPTION	DATE	REDEMPTION	DATE	REDEMPTION
1834.....	\$76,248,000	1842.....	\$105,000,000	1851.....	\$243,000,000
1835.....	95,543,000	1844.....	126,000,000	1852.....	245,000,000
1836.....	126,691,000	1845.....	137,000,000	1853.....	288,000,000
1837.....	105,457,000	1846.....	141,000,000	1854.....	231,000,000
1838.....	76,634,000	1847.....	165,000,000	1855.....	341,000,000
1839.....	107,201,000	1848.....	178,000,000	1856.....	307,000,000
1840.....	94,214,000	1849.....	199,000,000	1857.....	376,000,000
1841.....	109,088,000	1850.....	220,000,000	1858.....	400,000,000

New York Safety Fund.

Adapted from an Article by L. Carroll Root in "Sound Currency Reform Club," 1895, pp. 288-299.

In the years 1826, 1827 and 1828 no bank charters had been granted; while of the forty then in force, thirty would expire between 1829 and 1833. The banks were making most strenuous efforts to secure the renewal of their privileges "without conditions or restrictions, or, as the bank men expressed it, with clean charters"; but so strong an opposition had meanwhile developed that in none of the several attempts made in 1828 to extend the charters of various banks was the requisite two-thirds vote secured.

In his message to the Legislature in 1829 Governor Van Buren called attention to the opportunity for reform given by the expiration of so many charters, and briefly outlined in general terms a plan for the improvement of the banking system of the State, which he said had been presented to him by Mr. Joshua Forman, of Syracuse. This plan was more fully described by Governor Van Buren in a second communication to the Legislature, January 26, 1829. In brief it contemplated a fund "to be raised from an annual payment of all the banks, according to capital, to be applied to the payment of the debts of such banks as shall fail; to go on accumulating until it shall amount to \$500,000 or \$1,000,000"; and when diminished by payments, to be brought up by further contributions. As to the origin of the idea, Mr. Forman himself says: "The propriety of making the banks liable for each other was suggested by the regulations of the Hong merchants in Canton, where a number of men, each acting separately, have, by a grant of the Government, the exclusive right of trading with foreigners, and are all made liable for the debts of each in case of failure. The case of our banks

is very similar; they enjoy in common the exclusive right of making a paper currency for the people of the State, and by the same rule should in common be answerable for that paper. This abstractly just principle, which has stood the test of experience for seventy years, and under which the bond of a Hong merchant has acquired a credit over the whole world not exceeded by that of any other security, modified and adapted to the milder features of our Republican institutions, constitutes the basis of the system."

Legislation.

The recommendations of Governor Van Buren were favorably received by the Legislature, and were made the basis of the Act of April 2, 1829, commonly known as the "Safety Fund" Act.¹

1829.—The leading provisions of this act were that every bank thereafter established, or thereafter securing an extension of its charter, should pay to the Treasurer of the State annually a sum equal to $\frac{1}{2}$ per cent of the capital stock of the bank, until the payments should amount to 3 per cent of the capital stock. The "Bank Fund" thus created was to be invested by the State—a part of the income being used to pay the salaries of the Bank Commissioners, the remainder being paid over to the contributing banks as a dividend upon their respective contributions—and was to be "inviolably appropriated and applied to the payment of such portion of the debts, exclusive of the capital stock, of any of the said corporations which shall become insolvent, as shall remain unpaid after applying the property and effects of such insolvent corporations, as hereafter provided." The method of procedure provided for by the act, in case of a failure, was, *First*: The distribution of the assets of the bank in the customary way; *Second*: After all the assets should have been turned into money, and the final distribution thereof made among the creditors, a Court of Chancery should enter an order, showing the amount necessary to discharge the *remaining* debts, and authorize the Comptroller to pay such amount from the Bank Fund. Then, and not until then, could any part of the fund be applied to the purpose for which it was designed. Finally, whenever the fund should be reduced by such payment, the Comptroller should call upon the banks for additional contributions to the fund—not to exceed, however, $\frac{1}{2}$ of 1 per cent annually to be continued until the fund should once more be made equal to 3 per cent of the capital stock of the banks.

The act also authorized the appointment of three Bank Commissioners, and contained provisions limiting the circulation to twice the capital

¹ Laws of 1829, Chap. 94, "An Act to create a fund for the benefit of the creditors of certain moneyed corporations, and for other purposes."

stock actually paid in, and the loans and discounts to two and one-half times the capital stock.

1837.—The act of May 8, 1837, enabled the authorities to take such measures as might be necessary for the immediate payment of the notes of any insolvent bank whose liabilities in excess of assets should not exceed two-thirds of the bank fund and allowed the Comptroller to use his discretion as to the measures to be employed. The method actually adopted, in most cases, was the redemption, by the Comptroller in Albany, of the notes of any failed bank, due notice to all being given by publication. After the other creditors of the bank should be satisfied, the amounts thus paid from the Safety Fund in the redemption of bills were to be repaid to the Comptroller from the remaining assets of the bank, if sufficient funds remained. At the final settlement of the affairs of the bank in this way, if the remaining assets should prove insufficient fully to reimburse the Bank Fund, the solvent banks should then be called upon to renew their contributions until the deficiency should be made good.

By the act of May 16, 1837—the act which authorized the suspension of specie payments—the amount of circulation permitted to be issued was restricted to \$150,000 on \$100,000 capital, \$200,000 on \$200,000 capital, \$800,000 on \$1,000,000 capital, \$1,200,000 on \$2,000,000 capital, etc.

1840.—By the act of May 14, 1840, all banks except those located in New York, Brooklyn or Albany were required to arrange for the redemption of their notes in New York or Albany, at not to exceed $\frac{1}{2}$ of 1 per cent discount.

1841.—The Bank Commissioners in 1841, after one or two serious failures had occurred, proposed:

(1) That the application of any portion of the fund to the redemption of notes of any insolvent bank should be considered as an absolute reduction of the fund, to reimburse which the banks should be required to renew their contributions to the Safety Fund immediately; or,

(2) That the receiver shall sell at public auction, after a short, stipulated period, the assets of the bank, and make the final dividend, with a view to bringing the case as speedily as possible within the provisions of the law of 1829.

The first of these provisions was subsequently adopted by the Legislature,¹ so that when the system was so severely shaken by the failures of 1841 and 1842, the Comptroller had authority to compel the banks to renew their contributions to the fund at once—an authority which he was not slow to utilize.

¹ Act of May 26, 1841, ch. 292, sec. 5.

1842.—April 12, 1842, when nine Safety Fund banks had failed, an act was passed providing that after the payment of the liabilities then charged against the fund, it should thereafter be applied only to the payment of circulating notes of failed banks. In anticipation of the facts which will be brought out later, it may be said, however, that the total remaining contributions of all the banks until the expiration of their charters, at various dates between 1845 and 1865, were hardly more than sufficient to pay the amounts charged against the fund at the passage of this act; so that the change came too late to be of any practical benefit in the administration of the system. It was hardly more than the recognition of the fact that a serious mistake had been made.

The Act of 1842 also authorized the redemption of the notes of insolvent banks in the order of the injunctions granted against them, continued the contributions from the banks, and provided that the annual contributions for the next four, five, or six years might be commuted by advance payments made in the notes of any insolvent bank at par, with an allowance of interest at the rate of 7 per cent to such dates as the contributions would regularly have become due. This provision, it will be noted, made a practical exception to the previously prescribed rule that the notes of all banks should be redeemed from the fund in the order of the injunctions, inasmuch as it allowed the notes of the bank last failing to be redeemed in this way alongside the notes of the earlier cases. This was an advantage accruing only to the banks; individuals holding the notes of the banks last failing could obtain no benefit from it.

1843.—In 1843, to guard against overissues, an act was passed providing for the substitution of notes registered and countersigned by the Comptroller, to be delivered to the banks in blank, for the hitherto unrecorded issues—their original plates being surrendered by the banks. The office of Bank Commissioners was abolished at this time, and the duties of that office assigned the Comptroller, to whom each bank was required to make quarterly reports.

1845.—By the Act of April 28, 1845, the Comptroller was authorized to issue stock on behalf of the State, redeemable from subsequent contributions to the Bank Fund, with which to secure funds promptly to settle with the creditors of the eleven Safety Fund banks which were then insolvent.

1846.—The next step of importance in the development of the bank-note currency of the State was the Constitution of 1846, making the notes a first charge upon all the assets of any bank or banking association, and making the stockholders individually responsible, each to the amount of the stock held by him, for all debts or liabilities contracted after January 1, 1850.

1848.—By the Act of April 12, 1848, it was provided that any bank with a capital of more than \$200,000 might issue notes up to the amount of capital paid in. The increase thus authorized was required to be secured by pledge of stocks in the same manner as the notes of "Free Banking" associations.

1866.—By Act of April 13, 1866, the Superintendent of Banking was directed to apportion the remnant of the Safety Fund then in his hands to the payment of circulation of failed banks still outstanding.

Experience.

During the same session of the Legislature in which the original act of 1829 was passed, sixteen banks were rechartered in accordance with its provisions, and eleven new banks, also subject to this law, were established. The New York City banks at first refused to accept charters under the law, though they were glad enough to do so later on, when it became apparent that it would be impossible for them to secure any extension of their charters except under the "Safety Fund" Act. In 1830, nine new banks were chartered; in 1831, eight (all New York City banks) were rechartered, and nine were newly established; in 1832, two were rechartered and seven were chartered; in the years 1833 to 1836, inclusive, twenty-eight new banks were chartered. In 1836 the capital of one bank—the Dutchess County Bank—was increased to \$450,000, and the bank placed under the provisions of the Safety Fund law, although the period of incorporation was not extended—it having then nine years yet to run. In 1839, two banks whose charters were about to expire were rechartered under the provisions of the Safety Fund law—their existence being continued until July 1, 1845. This makes a total of ninety-three banks, with an aggregate original capital of nearly \$38,000,000, either established or rechartered under this act; although the largest number ever in operation at any one time was ninety-one, with an actual capital of \$32,951,460.

First Resort to the Safety Fund.

The first occasion for the use of the Safety Fund occurred in 1837. Early in May of that year injunctions were issued against three banks in Buffalo—the City Bank of Buffalo, the Bank of Buffalo and the Commercial Bank of Buffalo. Immediately upon the passage of the Act of May 8, 1837, mentioned above, the Chancellor authorized the Comptroller to take such measures as he might deem necessary for the immediate payment of the ordinary notes of these banks.

Their outstanding circulation at the time was reported by the Bank Commissioners to be:

Bank of Buffalo	\$111,234
Commercial Bank of Buffalo	174,782
City Bank of Buffalo	127,845
Total	<u>\$413,961</u>

The "measures deemed necessary" by the Comptroller were to authorize and give public notice that the bills of those banks would be received in payment of canal tolls and all other debts to the State; a measure which gave general credit to the bills in actual circulation. Between May 8th and June 30th there had been redeemed from the Bank Fund, of the notes of the Bank of Buffalo, \$21,815; of the Commercial Bank of Buffalo, \$18,173; and of the City Bank of Buffalo, \$24,495. These advances, together with interest at 7 per cent, were repaid to the Safety Fund by the several banks on whose account they had been made.

In the same year the charters of two banks were repealed by the Legislature. These were the Sacket's Harbor Bank (charter repealed May 12, 1837) and the Lockport Bank (charter repealed May 15, 1837). On the 20th of May orders similar to those issued in the case of the Buffalo banks were issued authorizing the Comptroller to take measures for the immediate payment of the bills of these banks, after providing for the payment of the bills of the three banks against which prior injunctions had been granted. The reported circulation of the Sacket's Harbor Bank at the time was \$154,552; and that of the Lockport Bank, \$65,172.

"Notice was immediately given by the Comptroller that the bills of those banks would be received for canal tolls, and all payments to the State Treasury; . . . and the Comptroller did not deem it necessary to make any other provision than that before alluded to for the redemption of these bills, until a general arrangement was entered into by the banks for redeeming their bills in New York City. When this took effect notice was given that the bills of the Sacket's Harbor and Lockport banks would be redeemed at the bank where the Treasury deposits are kept in the city of Albany."¹

The charter of the Sacket's Harbor Bank was shortly afterward revived and all the charges on the fund on account of that bank were reimbursed by it as follows: Notes redeemed, \$92,361; accrued interest, \$814.29; total, \$93,175.29.

¹ Comptroller's Report, 1838, p. 16.

The charter of the Lockport Bank, however, was not renewed. The amount of bills redeemed from the Fund was \$36,168, in addition to which the bank itself redeemed at its own counters some \$20,000. The trustees of the bank paid over to the Comptroller, for the benefit of the Bank Fund, \$35,189.75, leaving unsettled a balance of \$978.25, together with \$2,021.75 accrued interest, which amounts were involved in controversy between the Comptroller and the bank. This was finally settled in 1841 by a special act of the Legislature which recognized the claim of the bank—the latter giving satisfactory security for the redemption of all its outstanding notes, and pledging itself to indemnify the Bank Fund against all claims upon it on account of any debts of the bank. The Safety Fund was therefore practically intact in 1840 when the first really serious failures occurred and stood at \$870,615.76.

Disastrous Failures.

In the years 1840–42 there came following, one upon another, eleven important failures, viz.:

- (1.) City Bank of Buffalo Feb. 3, 1840.
- (2.) Wayne County Bank Dec., 1840.
- (3.) Commercial Bank of New York Sept., 1841.
- (4.) Bank of Buffalo Nov. 2, 1841.
- (5.) Commercial Bank of Buffalo Nov. 15, 1841.
- (6.) Commercial Bank of Oswego Dec. 7, 1841.
- (7.) Watervliet Bank Mar. 9, 1842.
- (8.) Clinton County Bank Apr. 9, 1842.
- (9.) Lafayette Bank Feb., 1842.
- (10.) Bank of Lyons Sept., 13, 1842.
- (11.) Bank of Oswego , 1842.

In the case of the first three of these the Comptroller at once proceeded, in accordance with the Act of 1837, to redeem the notes as fast as presented. By the contributions of the banks in January, 1841, the fund was brought up to about \$914,000.

From the terms of the Act of 1837 the Comptroller considered it manifest that the immediate redemption of notes of failed banks was to be provided for only so long as one-third of the Bank Fund should still be left untouched and that until further contributions were made to the fund he had at his disposal, for the purpose of redeeming notes, only two-thirds the aggregate contributions up to date, or less than \$610,000. When the Commercial Bank of New York failed in September, 1841, \$427,876 of this had already been exhausted in the redemption of the notes of the City Bank of Buffalo and the Wayne County Bank. The redemption of the bills of the Commercial Bank of New York took \$118,631 more before the close of the year. This left the Comptroller

only about \$60,000 from the amount he felt authorized to apply to this purpose, and when the Bank of Buffalo failed in November, 1841, with a reported circulation of \$290,000,¹ the Comptroller expressed his belief that there was no legal authority for undertaking the redemption of the bills of this bank.

The Bank Commissioners, however, interpreting the law to mean that the redemption of notes should be provided for if the liabilities, over and above the assets, did not exceed two-thirds of the *balance of the bank fund* then unexpended, authorized the Comptroller to take measures for the payment of the notes of the Bank of Buffalo. The immediate question in dispute was rendered of less importance by the fact that the Comptroller had already issued a call for a further contribution of $\frac{1}{2}$ of 1 per cent from each bank, to be paid on or before January 1, 1842, which added \$161,899.19 to the fund.

Though several other failures followed closely on that of the Bank of Buffalo, it was deemed impossible to utilize any portion of the Bank Fund for the redemption of their bills, the balance then being only about \$300,000—which must be set apart for the depositors and other creditors of the banks previously failed.

At this juncture came the passage of the Act of 1842, permitting the banks to anticipate their annual contributions for the next four, five or six years by advance payments in which the notes of any of the then insolvent banks would be received.

The banks quite generally took advantage of this provision, as considerable amounts of the bills of broken banks had collected in their hands, in most cases accepted at a considerable discount, and the opportunity to invest them at par in such shape that they would be drawing 7 per cent interest was eagerly seized. Within the six months allowed them by the act sixty-four banks had paid up nearly half a million dollars, in the notes of the following banks—all of which became insolvent subsequent to the Bank of Buffalo:

Commercial Bank of Buffalo	\$138,528
Commercial Bank of Oswego	140,330
Watervliet Bank	98,877
Lewis County Bank ²	636
Bank of Lyons	25,545
Lafayette Bank	14
Clinton County Bank	73,679
Total	\$477,609

¹ The actual circulation, as shown by subsequent developments, was over \$400,000.

² The Lewis County Bank was temporarily enjoined during a part of the year 1842, which accounts for its appearance here. It shortly afterward resumed business and thereafter redeemed its own notes.

In addition to the \$477,609 thus virtually redeemed from the Bank Fund, the Comptroller exchanged \$100,000 of 7 per cent Bank Fund stock for \$60,000 in notes of the Bank of Buffalo, \$20,000 in notes of the Commercial Bank of Buffalo, and \$20,000 in current funds.

In May, 1843, the Comptroller was enjoined from using any portion of the Bank Fund for the purpose of paying creditors of any bank that may have become insolvent since the failure of the Bank of Buffalo, without reserving enough to pay all the creditors of the Bank of Buffalo and the three banks whose failures had preceded it. The object of this was, of course, to protect the interests of the depositors and other general creditors of the City Bank of Buffalo, the Wayne County Bank, the Commercial Bank of New York, and the Bank of Buffalo. Until all the debts of these four banks were provided for not even the notes of the banks that failed later could be redeemed.

During the next year the Comptroller continued the redemption of the notes of the four first-mentioned banks and by September 30, 1844, the total redemptions—including also the amounts received in commutation of contributions to the safety fund and the amounts for which stock had been exchanged—amounted to \$1,502,170; while the bank fund on hand at the same date amounted to \$145,493.72.

In accordance with the Act of April 28, 1845, the Comptroller issued stock for the payment of which the future contributions of the remaining banks of the system were pledged, and with the proceeds prepared to settle up all charges against the Safety Fund. June 6, 1845, he gave notice that he would redeem at par the outstanding notes of all insolvent banks, and between that date and Sept. 30, 1850, he did redeem such as were presented—amounting to about \$113,000—\$37,754 of which was by the issue of stock and the remainder by the payment of cash from the fund. This made the total redemptions on account of the notes of these banks, up to September 30, 1850, as follows:

City Bank of Buffalo	\$317,107
Wayne County Bank	113,131
Commercial Bank of New York	139,837
Bank of Buffalo	435,540
Commercial Bank of Buffalo	186,861
Commercial Bank of Oswego	163,162
Watervliet Bank	134,107
Clinton County Bank	71,896
Bank of Lyons	52,898
Lafayette Bank	38
Total	\$1,614,577

It would appear from later reports that subsequent to 1850, some \$725 was paid out in redemption of additional bills of these banks, but

it is impossible to ascertain the individual banks to which this should be charged.

Payment of Other Creditors Than Note Holders.

The Act of 1845 recognized the liability of the fund not only as toward the holders of the circulating notes, but also to the general creditors of the banks that had already failed, and provided the means for meeting their demands. It called, first, upon the several receivers to furnish estimates of the additional amounts required to enable them to pay all their creditors, and directed the Comptroller to issue State stock to an amount sufficient to meet all the demands against the fund.

In December, 1845, the receivers of six banks reported that the following amounts would be required to enable them to pay off their creditors: Bank of Buffalo, \$150,000; Commercial Bank of Buffalo, \$435,000; Watervliet Bank, \$100,000; Commercial Bank of Oswego, \$90,000; Clinton County Bank, \$142,000; Bank of Lyons, \$100,000; total, \$1,017,000.

The method of settlement followed by the Comptroller was, in general, taking up the creditors of only one or two banks at a time, to pay all debts of less than \$1,000 in cash, and issue stock in payment of all claims for larger sums. During the few months intervening between the passage of the Act and the close of the fiscal year, September 30, 1845, he settled with all the general creditors of three banks, liquidating claims to the following amounts: Bank of Buffalo, \$149,241.22; Commercial Bank of New York, \$146,129.23; Commercial Bank of Oswego, \$78,351.63; total, \$373,722.08—of which \$69,488 was by payments of cash from the Fund, and \$304,233.69 by the issue of stock. This was the first application of any portion of the Safety Fund to debts other than circulation. In the course of the next year the creditors of the Commercial Bank of Buffalo were settled with in full and a beginning made with the creditors of the other banks, which were shortly afterward disposed of.

By 1851 the following amounts had been paid out in settlement of debts other than circulation:

Wayne County Bank	\$16,077.70
Commercial Bank of New York	146,129.23
Bank of Buffalo	149,241.22
Commercial Bank of Buffalo	424,514.87
Commercial Bank of Oswego	78,351.63
Watervliet Bank	77,484.09
Clinton County Bank	156,257.39
Bank of Lyons	40,053.08
Total	<u>\$1,088,109.21</u>

Of the whole eleven banks whose failures occurred so near together, only two—the Lafayette Bank of New York and the Bank of Oswego—found themselves able to settle with all their creditors and redeem all their circulating notes without calling upon the Bank Fund for assistance.

The contributions of the solvent banks had by this time so far surpassed the current demands upon the fund that by September, 1850, the Comptroller had been able to call in and pay off over \$200,000 of the Bank Fund stock, leaving outstanding on that date \$715,905.33.

The creditors of the banks having been in this way satisfied either by means of payments from the fund or the issue of Bank Fund stock, the Safety Funds became the natural claimant for whatever amounts should be realized from the remaining assets in the hands of the receivers, up to the full amount advanced.

In December, 1845, the receivers had reported the amounts of assets sold and on hand, and estimated the value of the remaining assets as follows:

	Assets at Failure	Amount Realized	Amount of Assets Unsold	Estimated Value of Unsold Assets
City Bank of Buffalo	\$759,017.35	\$166,576.08	\$570,000.00	\$50,405.00
Bank of Buffalo	1,221,843.30	82,836.69		
Commercial Bank of Buffalo	985,063.92	172,863.64	456,447.31	49,689.86
Wayne County Bank	293,970.39	56,743.60	246,200.69	22,627.53
Bank of Lyons	385,608.08	37,444.64	236,229.34	11,524.47
Bank of Oswego	213,353.25	32,693.00	163,813.00	a
Clinton County Bank	543,429.66	76,019.47	64,381.57	12,752.65
Commercial Bank of New York	858,471.68	303,338.74	301,405.96	b
Watervliet Bank	202,378.91	19,458.73	204,137.49	
Commercial Bank of Oswego	507,173.36	80,652.59	94,087.19	10,525.15

(a) Receiver of the Bank of Oswego unable to affix any definite value to remaining assets. Thinks they will prove sufficient to pay all the debts of the bank by the following summer.

(b) The Commercial Bank of New York had already realized enough to declare a dividend of 70 per cent to its creditors. Impossible to assign values to remaining assets; but thinks it quite probable that there will still be a deficiency to be met by the Safety Fund.

After the assumption and settlement of the debts of the several banks by the Comptroller, the conversion of the remaining assets into cash became slow. In some instances the receivers advertised and sold the assets at public auction, in which case the Comptroller usually appointed an agent to look after the interests of the Safety Fund and bid in such assets as seemed to be going at a sacrifice. In this way, in November, 1845, the Comptroller bid off for \$16,900 assets of the City Bank of Buffalo of a nominal value of \$470,000. Likewise the most of the remaining assets of the Watervliet Bank were bid off by the Comptroller. In the cases where the receiver continued the slow process of collecting the assets, the proceeds, after expenses were deducted, were turned over

to the Comptroller from time to time, and where the assets themselves came into the hands of the latter, as fast as anything was realized from them it was turned into the Bank Fund. The amounts thus realized between 1845 and 1866 were as follows:

City Bank of Buffalo	\$99,995.52
Watervliet Bank	13,258.52
Bank of Lyons	3,760.60
Commercial Bank of Oswego	2,392.33
Commercial Bank of New York	7,188.17
Commercial Bank of Buffalo	5,000.00
Banks not specified in reports	6,482.24
Total	<u>\$138,077.38</u>

The Comptroller on several different occasions called attention to the fact that these assets were not being turned into money as rapidly or to so large an extent as they might be if in the hands of individuals, and requested authority to sell those still remaining in his hands for what they would bring. This authority, however, was not given him, and considerable amounts that could probably have been collected if they had been given careful attention, were allowed to remain uncollected until the statute of limitations effectually cut off all hope of realizing anything further.

To summarize the transactions between these insolvent banks and the Safety Fund and to present briefly the more important facts in regard to each, the following will prove valuable:

	Capital Stock	Circulation Allowed	Circulation Reported to Failure	Circulation Outstanding at Failure, as Reported by Receiver	Payments From the Bank Fund		Receipts From Assets, Paid to Bank Fund	BALANCE
					In Re- demption of Notes	In Payment of Other Debts		
City Bank of Buffalo.....	\$400,000	\$300,000	\$268,922	{ \$122,038 }	\$317,107	\$16,077.70	\$99,995.52	\$217,111.48
Wayne County Bank.....	100,000	150,000	144,392	{ 17,354 a }	113,131			129,208.70
Commercial Bank of New York.....	500,000	350,000	121,370	{ 120,000 }	139,837	146,129.23	7,188.17	278,778.06
Bank of Buffalo.....	200,000	200,000	195,760	{ 265,000 }	435,549	149,241.22		594,781.22
Commercial Bank of Buffalo.....	400,000	300,000	246,662	{ 488,257 c }	186,861	424,514.87	5,000.00	606,375.87
Commercial Bank of Oswego.....	250,000	225,000	216,096	{ 197,650 a }	163,162	78,351.63	2,392.33	239,121.30
Watervliet Bank.....	250,000	225,000	114,510	{ 21,537 b }	134,107	77,484.09	13,258.52	198,332.57
Clinton County Bank.....	200,000	200,000	167,781	{ 66,779 }	71,896	156,257.39		226,153.39
Bank of Lyons.....	200,000	200,000	80,825	{ 80,424 a }	52,898	40,053.08	3,960.60	88,990.48
Latayette Bank.....	500,000	350,000	71,598	{ 109,000 }	38			38.00
Oswego Bank.....	150,000	175,000	95,450		725		6,482.24	
Total.....	\$3,150,000	\$2,675,000			\$1,615,302	\$1,088,109.21	\$1,338,277.38	\$2,565,133.83

a. Claimed as belonging to the bank mainly in the hands of redemption agencies.

b. Held by other banks as collateral security.

c. About \$100,000 of these notes were claimed as being the property of the bank, held by others mainly as collateral security.

After the failure of these eleven banks, as already outlined, the Safety Fund was left in such shape as to afford little security for the circulation of the remaining banks, the future contributions being practically mortgaged to their full extent by the outstanding Bank Fund stock, amounting at one time to more than \$900,000. To the extinguishment of this debt the annual contributions of the remaining banks were applied.

Happily the failures of the remaining period were few, numbering but five.

The Canal Bank of Albany, with a capital stock of \$300,000, had outstanding in July, 1848, when it failed, circulating notes to the amount of \$185,531. But meanwhile the new Constitution of 1846 had made the circulating notes a first charge upon the assets. The receiver, accordingly, redeemed the circulation at once, and the Bank Fund, therefore, did not enter into the case at all. So far as can be ascertained, there was no depreciation of the notes in the hands of other banks or the public at the time of the failure.

The Lewis County Bank, which failed in November, 1854, was not so fortunately situated. This institution, located at Martinsburg, had a nominal paid-up capital of \$100,000, and under the existing law was entitled to issue \$150,000 circulation. How near it came to being a bank of issue, pure and simple, can be determined from its last annual statement previous to failure, which reported the liabilities to the public to be:

Circulation	\$148,545
Deposits	1,998
Due other banks and corporations	961
Total	<u>\$151,504</u>

At the time the bank passed into the hands of the receiver there were no liabilities whatever on account of deposits or other debts than circulation.

Although it became apparent at once that the receiver would be unable to collect sufficient funds to redeem the notes of the bank, the Safety Fund could then afford no assistance. For, as has already been pointed out, all future contributions to that fund until after 1860 were pledged for the redemption of the Bank Fund stock which had been issued in 1845 and 1846 to settle with the creditors of the banks which had then become insolvent. Twelve years later arrangements were made whereby the notes still outstanding were finally redeemed from the surplus of the Safety Fund after the payment of the stock issued against it.

The crisis of 1857 brought in its train the downfall of three more

safety fund banks, whose outstanding circulation at the time was reported as follows:

Bank of Orleans	\$200,000
Reciprocity Bank	159,577
Yates County Bank	148,958
Total	\$508,535

In these cases, however, the assets were such as to enable a much larger part of the circulation to be redeemed. By 1866 the outstanding notes had been reduced in amount to:

Bank of Orleans	\$ 7,598
Reciprocity Bank	10,744
Yates County Bank	18,715
Total	\$37,057

In his report for 1867 the Superintendent of Banking states the outstanding circulation of these four latest failures to have been reduced to \$129,499. The surplus fund remaining at his disposal after the last of the Bank Fund stock had been provided for enabled him to declare a dividend of 40 per cent on these notes. But at the end of the year so few of the notes had been presented—mainly owing, doubtless, to the destruction of the greater part of the notes of the Lewis County Bank in the twelve years that had elapsed since its failure—that the Superintendent was able to redeem in full the certificates for the unpaid 60 per cent given upon payment of the first dividend to the bill holders. There was then still left a balance of \$13,144.19, which was paid into the Treasury. A part of it was afterward paid to the representative of the Bank of Oswego for excess of contribution in 1842.

From the inception of the Safety Fund to its close the total contributions thereto amounted to \$3,104,999.51; and the total payments therefrom including not merely the circulating notes, but, as to the earlier failed banks, all other liabilities, comprising depositors' accounts—amounted to less than \$2,600,000, the remainder having been paid as interest for advances to the fund in 1845–6, to enable it to meet the extraordinary losses of that period.

Defects and Remedies.

Political charters.—The practice of granting special banking charters gave way in 1838 to a system of banks incorporated under general law—a change brought about largely by a widespread reaction against the corruption which had crept into the establishment and management of the specially chartered banks during the previous decade.

It must be remembered that up to this time, in the State of New York, as in the greater part of the United States, banking was a monopoly; and the issue of a charter for bank purposes was the grant of an important privilege, for which concessions were occasionally required to be made the State, but which was more often included in the general distribution of the spoils of office among the friends of the dominant party in the Legislature. It is little wonder, therefore, that this became a favorite field for corruptionists, and that the legislative struggles over the granting of bank charters were oftentimes violent almost beyond description.

Even after the legislative battle had been fought and won, the distribution of the stock was still a matter for dispute. This was generally intrusted to the Bank Commissioners or to specially appointed agents, and was not often managed in such a way as to give the best of satisfaction.¹

Nor was this most unsatisfactory method of inaugurating banking corporations lacking in effect upon their subsequent career. The means and methods employed in their establishment led to unsound and often deceptive management. Many of the banks chartered when the scandal was at its highest were originally organized and subsequently managed by a few individuals solely with a view to profitable speculation in their stock. The real strength of the system was in its older banks, and its weakness in those chartered under the conditions suggested above. . . . Of the twenty-eight older banks rechartered and doing business under the safety-fund system none failed. But of the sixty-four new banks chartered in the seven years following the passage of the Safety Fund Act no less than sixteen afterward failed, and the charter of one other was revoked by the Legislature on account of its unbusiness-like transactions.

Speculative banking.—Then, too, the period following the expiration of the charter of the Second United States Bank was one of excessive speculation. There was not only an undue expansion of the field of banking by which banks were established where no legitimate demand for them ever existed, but the speculative mania which had fastened upon nearly every branch of business involved the customers of every banking institution, while the competition among banks themselves led to careless scrutiny of commercial paper.

. . . Of the forty-four banks newly chartered between 1829

¹ On this point the Bank Commissioners, in their report for 1837, say:
"The distribution of bank stocks created at the last session has in very few, if any, instances been productive of anything like general satisfaction. In most instances its fruits have been violent contention and bitter personal animosities, corrupting to the public mind and destructive of the peace and harmony of society."

and 1833, inclusive, seven afterward failed; while of the twenty banks chartered in the speculative years 1834-36 no less than ten afterward became insolvent. That record—a mortality of 50 per cent—shows more plainly than any extended discussion can do that the failures which so shook the system in 1841-42 are traceable more or less directly to the management of these institutions organized during the area of speculation commencing early in the thirties and culminating in the commercial crisis of 1837-1839.

Overissues.—One of the first lessons learned was that the safety of the system demanded more perfect security against fraudulent overissues of circulating notes.

Until 1837 the circulation of the safety fund banks was limited by their charters to twice the amount of their capital stock. But by the act which authorized the suspension of specie payments, further limitations were placed upon the issue of notes, as follows:

Capital.	Circulation.	Capital.	Circulation.
\$100,000	\$150,000	\$500,000	\$350,000
120,000	160,000	600,000	450,000
150,000	175,000	700,000	500,000
200,000	200,000	1,000,000	800,000
250,000	225,000	1,490,000	1,000,000
300,000	250,000	2,000,000	1,200,000
400,000	300,000		

In 1848, the limit in the case of banks of more than \$200,000 capital was increased to the full amount of their capital.

In the case of the City Bank of Buffalo (see table above) the actual redemptions from the Bank Fund after failure exceeded the lawful circulation by \$17,107, and the previously reported circulation by nearly \$50,000. In the case of the Commercial Bank of the same city it was ascertained that the amount of its bank notes out of its control at the time of the failure was \$488,257—nearly twice the lawful issue—though in this case the larger part of the notes were returned to the bank and the final redemptions from the Safety Fund fell within the prescribed limit.

But the most flagrant violation in the way of fraudulent overissue occurred in connection with the Bank of Buffalo. This bank, having a capital of \$200,000, was lawfully entitled to issue notes only up to that amount. The discovery that its issues were \$13,000 in excess of this was one of the causes of the injunction granted in November, 1841. A thorough examination of the books and accounts of the bank led to the belief that there was about \$290,000 outstanding. The exact amount was never definitely ascertained, but aside from any amounts that may have been lost or that received by the bank itself in the settlement of its

affairs, the Comptroller redeemed from the Safety Fund no less than \$435,540—\$235,540 in excess of the maximum prescribed by statute.

The overissues of these two banks alone—the City Bank of Buffalo and the Bank of Buffalo—cost the Safety Fund \$252,647 more than the maximum circulation to which they were entitled; while an examination of the affairs of all the insolvent banks showed that their actual outstanding circulation at the time of failure amounted in the aggregate to \$600,000 more than that stated in their last annual returns, a difference much too great to be due to any actual increase in the circulation.

The act of 1843 corrected the defect noted by providing for issue by the Comptroller in blank and registry of all State Bank bills.

Application of the Safety Fund.—The experience in this regard has been too fully given above to make it necessary here to do more than note how illogical was the original use of the Safety Fund to pay local depositors as well as note holders; how disastrous in practice was the result, and how this was remedied.

Mistaken basis for the assessment.—The Safety Fund was to be made up and kept good by an assessment (whenever required) of $\frac{1}{2}$ of 1 per cent per annum upon the *capital* of the co-operating banks. It was only in the most imperfect way that in the case of each bank, after 1837, its capital corresponded to its authorized circulation; while almost exclusively it was the smaller banks which, deriving from their circulation the greater proportion of their profits, continually kept near the limit in this regard. As a consequence, not merely were the strong banks unduly burdened to guarantee the notes of the weak ones, but, since the assessment to be paid by each was unaffected by the amount of its outstanding notes, such assessment was no obstruction to increase of circulation. Had it been based instead upon the average amount of outstanding circulation, not merely would the law more promptly have provided against overissues, but to some extent the tax itself would have been a brake upon excessive issues. Such were among the considerations which, at the very outset, were the grounds for complaints by the larger New York banks, and which would doubtless have been remedied had not an entirely different system been adopted before the Safety Fund plan itself had been perfected.

Results.

As the weak points noted became apparent the Legislature was prompt to apply remedies, as noted in the chapter on legislation at pages 358–361. How appropriate and effective were the means thus adopted can perhaps be so well illustrated in no other way as by the calculations

below of what would have been the actual experience of the Safety Fund Act had it included from the beginning the features which, on the suggestion of experience, were adopted by amendment.

In actual practice the Safety Fund was depleted by drafts not consistent with proper legislation; and which were actually stopped by amendment of the law—too late, however, to prevent serious results:

First.—As to obligations of banks accrued before April, 1842, the Safety Fund was used to pay depositors and other creditors, as well as to redeem outstanding circulation; and \$1,088,000 was thus used to pay debts other than circulation.

Second.—Prior to 1843 there was no registry of notes or safeguards against overissues. As a consequence there were redeemed from the Safety Fund \$252,647 of notes in excess of legal issues, and a much larger amount in excess of reported issues.

Third.—On account of these illegitimate drafts the Safety Fund had to be made good by loans, the interest on which before they were repaid from the proceeds of the annual $\frac{1}{2}$ per cent assessments on bank capital was \$500,000.

Eliminating these alone, the following is a statement of what the results of the experience with the Safety Fund system would have been had the legislation before the failures of 1840–42 taken the form of the act as perfected by subsequent legislation.

Aggregate demands upon the fund: Circulation, \$1,615,000, less \$255,000 overissues (which would then have been impossible), or \$1,360,000. This demand, however, would not all have accrued at once. Four hundred and thirteen thousand dollars was on account of banks failing prior to January 1, 1841; \$1,100,000 on account of banks failing prior to January 1, 1842; and \$1,360,000 for banks failing prior to January 1, 1843. Annual contributions being resumed as soon as the fund was in any way depleted, in January, 1841, it would have amounted to \$1,076,000; \$1,238,000 January 1, 1842, and \$1,400,000 January 1, 1843. The Comptroller, being hampered by no necessity for reserving a part of the fund to pay general creditors, would have been free to redeem the outstanding notes of each bank immediately upon the granting of the injunction against it. There would, therefore, have been no cause for depreciation of the bills of any of these banks; but all would have been promptly redeemed at par. And after all note-holders were paid there would still have been a small surplus, which the regular $\frac{1}{2}$ per cent contributions of the banks would soon have raised to the required 3 per cent. Not only, therefore, would the fund have been adequate to meet, as it was presented, the circulation of the banks that failed in 1840–42, but would have afforded ample security for the

circulation of the remaining banks until the expiration of their charters, redeeming at once and in full the notes of the four banks which failed in 1854 and 1857, and still leaving a surplus to be returned to the contributing banks upon the expiration of their charters.

In this summary nothing is said of the first lien given the notes of an insolvent bank by the constitution of 1846, which alone would have reduced the charge upon the Bank Fund by more than \$800,000.

Nor has the effect of the individual liability of bank stockholders, under the Constitution, accruing after 1850, been taken into account.

And a most important factor is still to be noted. The natural effect of a system can be seen only when it is allowed its natural development. Had not the "Free Banking" system been adopted in 1838, the Safety Fund assessments would have been based on a constantly widening basis. At it was, they were paid on a constantly diminishing capital, as the charters of the Safety Fund banks expired.

Taking these considerations into account, it is plain, as the result of calculation from experience of 36 years (1829—1865), that, had the Safety Fund system—as perfected prior to and in the constitution of 1846—been left untouched as that upon which New York State bank currency was based, not merely would every dollar of circulation have been kept good, but the total assessment to keep the fund good would have averaged less than $\frac{1}{4}$ per cent on the banking capital, or about $\frac{3}{8}$ per cent on the average circulation outstanding.

Why the Safety Fund system was superseded.—The system of granting special charters had given rise to such abuses, both in the distribution of the stock of the Safety Fund banks and in their subsequent management by bank commissioners, whose appointment was within the field of political spoils, that the whole system was abandoned and in 1838 a general banking law enacted, under which individuals or associations with requisite capital might engage in the business of banking by depositing with the Comptroller certain specified securities upon which circulating notes were issued. After the passage of this general law no new special charters were granted, though two of the older chartered banks after this entered the Safety Fund system with extended charters.

The safety fund system was thus *the* banking system of the State during the years 1829–38—all the charters granted in this period being under it; while from 1838 until 1866, when the last charters expired, it was an organized, working system, existing alongside the banks incorporated under the general law. It is a fact perhaps worthy of notice that this abandonment of the system took place before any real failure had occurred to try its strength, and was not due to any failure of the

safety fund to afford the requisite security to the bill holder. On the contrary, upon each of the occasions when its assistance had been invoked—involving the redemption of the notes of five different institutions—it had met every requirement; all advances on account of the suspensions had either been entirely restored or were fast being repaid; and not a dollar had been finally lost on any bank note issued under the system during the nine years it had then been in force.

New York Free Banking Law.

Adapted from an Article by L. Carroll Root in "Sound Currency Reform Club," 1895, pp. 299-305.

Bond Deposit System—"Free Banking."

For years prior to 1838 the political situation in New York had been such as to tempt criticism of Safety Fund banking as something for which the Federalists were responsible, and now the Democrats, after having made the question an issue for several campaigns, found themselves in a position to put into legislation the counter theories they had advocated. The Free Banking Act of 1838 was the result; to the perfection of which was devoted such of financial experience and tact as could then be utilized in behalf of a special security system.

The Safety Fund law had been a comparatively novel application to banking of principles long familiar in the conduct of other business; the Free Banking Act was the development of the rival principle of special security, which had maintained from time immemorial in the banking business as well. Had the Safety Fund not been pre-empted by their political opponents there was no reason why the free banking advocates should not have adapted it to their plans. At it was, however, their criticism had been too universal to make it easy for them to adopt any part of the system they had denounced. As a result, the Free Banking Act was carefully drawn, not merely to do away with the "monopoly" which had been denounced as an incident of the Safety Fund system, but to exploit as far as possible the theories opposed to those upon which it was based; and, since the Safety Fund system still continued in operation, a most instructive experience, under similar conditions, of contrasting systems was the result.

Legislation.

1838.—The Free Banking Act, based upon a bill drawn by Abijah Mann, bears date of April 18, 1838. Under it individuals or associa-

tions were authorized to engage in the business of banking, and to receive from the Comptroller circulating notes in blank, duly registered and countersigned, upon depositing with him the stocks of the United States, of the State of New York, or of any other State approved by the Comptroller, made equal to a five per cent stock of the State of New York, or bonds and mortgages on improved, productive, and unincumbered real estate, worth double the amount secured by the mortgage, and bearing interest at not less than 6 per cent per annum. The banks might deposit stocks only, in which case the notes were printed in a manner to indicate that they were so secured; or they might deposit half stocks and half bonds and mortgages, when that fact was likewise shown by the notes.

By this general act each association desiring to operate under its provisions was authorized to fix its own corporate name; determine the amount of its capital, and the period of its corporate existence; designate the place where its banking operations shall be carried on, and to provide by its articles of association for an increase of its capital, should it be so desired.

Associations were required to have a paid-up capital of \$100,000. Individuals, being subject to unlimited liability in any event, were not required to show evidence of any special amount of paid-up capital; and neither associations nor individual bankers were required to deposit any specified amount of securities.

In case of failure or refusal on the part of the association or individual issuing notes to redeem them on demand at the place where they were made payable, after ten days' public notice of protest for nonpayment, the Comptroller was authorized to apply the trust funds deposited for their security to the payment and redemption of the notes. The State, however, was liable for nothing beyond the proper application of the securities pledged.

Detailed semiannual reports were required to be made.

The act of 1838 also provided for a specie reserve of not less than $12\frac{1}{2}$ per cent to be kept by each association, against its circulating notes.

1840.—By the act of May 14, 1840, all banks, banking associations, or individual bankers, except those located in New York, Brooklyn or Albany, were required to arrange for the appointment of agents in the city of New York or Albany for the redemption of their notes at a discount not exceeding one-half of one per cent.

A wave of repudiation, or semirepudiation, of State indebtedness having begun in 1839, as a result of which attention was drawn to the uncertainty and undesirability of stocks of other States as security for

notes issued under the General Banking act, the Legislature, by the act of May 14, 1840, excluded from future deposits all stocks except those issued by the State of New York. This, however, did not require the stocks of other States already on deposit to be replaced by New York State stocks.

This same act provided that no association should commence the business of banking until it had deposited with the Comptroller the securities required by law to the amount of \$100,000, and effectually cut off the issue of post notes—a practice which was becoming quite prevalent—by an express inhibition against any banking association or individual banker issuing any bill or note, “unless the same shall be made payable on demand and without interest.”

The 12½ per cent specie reserve requirement was repealed by this act.

1841.—The provisions of the original act in regard to the application of “the said trust funds belonging to the makers of such protested notes to the payment and redemption of such notes” having been held to authorize payment in full of the holders of protested notes at the expense of the holders of the remainder of the circulation, the act of March 15, 1841, was passed, providing for the “payment pro rata, of all such circulating notes, whether protested or not.”

By the act of May 26, 1841, annual reports to the bank commissioners were substituted for the semiannual reports to the Comptroller theretofore required. Provision was also made that any bank having redeemed 90 per cent of its circulation, after two years’ published notice, should receive from the Comptroller any securities he may hold for the payment of its unredeemed notes.

1843.—The “act to abolish the office of Bank Commissioner,” April 18, 1843, substituted for annual reports detailed quarterly reports to the Comptroller.

1844.—To guard more carefully the business of individual bankers it was provided by the act of May 6, 1844, that no individual banker shall receive circulating notes until he shall have deposited with the Comptroller the securities required by law to the amount of \$50,000; that every such banker shall state in his reports what persons, if any, are interested with him; and shall file with the Comptroller “a certificate, stating the town, city, or village, in which he resides; and thereafter it shall not be lawful for such individual banker to transact business under said act in any other place than in which he resides.”

1846.—The new State Constitution required that provision should be made by law for all notes circulating as money, and for ample security for their redemption in specie; also that shareholders of note-issuing

banks should be individually responsible to the amount of their respective shares for debts contracted after January 1, 1850; also that in case of insolvency bill holders should be entitled to preference in payment over all other creditors of the bank, etc.

1847.—By the act of December 4, 1847, the method of calling for quarterly reports was so changed as to require them to be made out after the first of each quarter for some day during the preceding quarter, then designated by the Comptroller.

1848.—By the act of April 12, 1848, it was required that "all banking associations or individual bankers," organized under the general banking law, "shall be banks of discount and deposit as well as of circulation, and the usual business of banking shall be transacted at the place * where such banking associations or individual bankers shall be located," as designated in certificate, "and not elsewhere"; and in each report it is required to be stated that "the business of said association or banker has been transacted at such location."

This same act required that New York stocks thereafter deposited should be, or be made equal to, 6 per cent stock, instead of 5 per cent as theretofore. The basis of mortgages was at the same time raised to 7 per cent, in amount not exceeding two-fifths the value of the lands exclusive of buildings, and no mortgage to be for a greater amount than \$5000.

1849.—The Legislature in 1849 (April 5th) passed a comprehensive act providing for the enforcement of the double liability of stockholders of banks and banking associations subsequent to January 1, 1850, in accordance with the Constitution of 1846.

By the act of April 10, 1849, United States 6 per cent stocks were admitted for deposit on equal terms with New York stocks, except that at least one-half of the stocks deposited must still be New York State stocks.

1850.—By the act of April 10, 1850, the method of final distribution of funds arising from sale of securities deposited by associations or individual bankers which shall have failed, was more definitely prescribed. After the expiration of six years after sale of the securities, the balance of the fund remaining after six weeks' published notice was to be put to the credit of outstanding certificates if the notes previously redeemed had not been redeemed at par; otherwise, turned over to the association by which they had been deposited.

1851.—By the act of April 12, 1851, "To organize a Bank Department," the appointment of a Superintendent of Banking was authorized, to whom all reports were thereafter made.

By the act of April 15, 1851, the city of Troy was added to the

redemption cities, and the maximum discount at redemption agencies reduced to one-fourth of one per cent.

1863.—By the act of April 29, 1863, bonds and mortgages were finally discarded as a basis for circulation, and securities for deposit restricted solely to stocks of the State of New York and of the United States, not more than two-thirds of which might be United States stock.

Experience.

By January 1, 1839, 48 persons or associations had filed the requisite certificates in the office of the Secretary of State. The amount of capital subscribed by them was \$10,838,175, the total amount of stocks transferred as security for circulating notes by the 16 associations which had commenced operations was \$1,170,090, and the total amount of mortgages transferred was \$422,910; about \$75,000 were rejected as unsatisfactory. The amount of circulation actually issued at that time, however, was but \$396,300. By December 1, 1839, the number of associations had increased to 133, of which 76, with a total capital of \$21,000,000, and circulation of about \$6,000,000, were in full operation.

Already, however, it was evident that all would not be smooth sailing. The Comptroller, in his report for 1840, called attention to the fact that a sort of banking mania seemed to prevail, at the extent and possible results of which the community was becoming alarmed. One bank had already been wound up during the year, fortunately without loss to the bill holders; and similar results in the cases of two others were in prospect. The Comptroller, realizing that if in these early cases of failure the securities proved adequate to meet the circulation, additional confidence in the circulation would result, made every effort to secure that end.

Before the first of January, 1841, eight banking associations had ceased to do business. Four of these,¹ discontinued without loss to the holders of their circulating notes. The securities of one other—the Tenth Ward Bank—were sold and produced sufficient to pay 94 cents on the dollar. In the case of the bank of Tonowanda the depreciation in the value of the securities was such that the dividend on the notes was but 68 per cent. Each of the other banks—The Farmers' Bank of Seneca County and The Millers' Bank (Clyde)—had two classes of bills in circulation; those issued on the security of State stocks alone, and those based on State stocks and mortgages. In the case of each bank the proceeds of the securities were sufficient to redeem in full the notes issued upon the

¹ The Willoughby Bank (Brooklyn); The Farmers' Bank of Penn Yan; The N. Y. City Trust and Banking Co., and The Chelsea Bank.

pledge of State stocks alone; but of those secured by stocks and real estate, the notes of the Farmers' Bank were redeemed at 74 per cent. and those of the Millers' Bank at 94 per cent.

This, however, was only a beginning of the failures. Eighteen more followed in the course of the next year. Those notes secured by deposit of State stocks were redeemed at an average discount of 20 per cent, and those secured by stock and real estate at a discount of about 25 per cent.

In 1844, the Comptroller reported that, up to that date, 93 free banks had deposited securities and received and issued circulation. Of these, eight had voluntarily closed business and retired their circulation. Twenty-six had failed, and their circulation, amounting in the aggregate to \$1,197,547, was taken up by the Comptroller at an average of 76 cents on the dollar. The remaining 59 associations and individuals had on deposit with the Comptroller, New York State stocks amounting to \$1,774,434; stock, \$52,000; cash, \$17,731; stocks of Michigan, Indiana, United States, Illinois, Arkansas, Alabama, Kentucky, and Maine, of the nominal value of \$3,744,829, but then valued by the Comptroller at \$2,745,156.¹

By 1848 the number of free banks was fifty-three, and of individual bankers fifty-one, with an aggregate circulation of \$9,993,762 against securities amounting to \$10,640,182. Of these securities, \$7,627,092 were New York State stocks, \$114,000 United States stocks, \$1,514,979 bonds and mortgages, and the remainder, except \$49,906 cash, consisted of stocks of Illinois, Arkansas, Indiana, Alabama and Michigan. In 1848 the Legislature, admonished by the insufficiency of the security in the case of earlier failures, made a change in the law, requiring that thereafter only New York stocks, made equal to 6 per cent; and bonds and mortgages bearing 7 per cent interest on real estate to the extent of two-fifths of the value of improved real estate, exclusive of the buildings thereon, could be received as security for circulation.

Millard Fillmore, Comptroller, in his report dated December 30, 1848, made just after his election as Vice-President of the United States, states that average amount for which bonds and mortgages held as security for circulation had sold during the previous ten years was 67.71 per cent, while five per cent New York State stock had sold at an average of 92.86 per cent. He recommended legislation providing for the gradual withdrawal of the bond and mortgage security and the substitution of New York State stocks.²

¹ Finding the small banks unsafe, the Legislature in 1844 required individual bankers to deposit securities to the amount of at least \$50,000; and associations to the amount of \$100,000, before they were entitled to any notes for circulation.

² The Superintendent of Banks, in his report for 1854, says upon the same subject: "It is believed that all the bonds and mortgages that have been sold under the provisions of the

In his report for 1844 the Comptroller called attention to the fact that "during the past year a number of applications have been made for the establishment of individual banks at points remote from the general channels of business, and where no necessity seemed to exist for banking facilities. Many of these individual banks have originated in the City of New York, and some in Albany. . . . The redemption at a discount of one-half of one per cent allowed by law is probably one of the principal inducements for establishing banks of this description. The notes are signed and circulated in the City of New York, and by fixing the place of redemption at some inaccessible point, the holder is compelled to go to the office where the note was really issued in Wall Street, and pay half of one per cent for its redemption. If all the banks in the State were required to redeem their notes at par in the City of New York, the motive for multiplying these shaving shops would probably be removed."

Considerable importance attaches to the practice which had thus developed of establishing banks for circulation purposes only, which did no real banking business. In a report made by a Senate Committee in 1845 the names of eight such associations are given, whose combined capital amounted to \$377,000; loans and discounts, \$37,920; and circulation, \$545,000. "It really could never have been the intent of the Legislature," continues the report, "to authorize the creation of such banks as these; and if they now have legal existence, it can scarcely be deemed sound policy to permit their continuance, or to sanction the establishment of others of like character."

The legislation of 1848, providing that "all banking associations and individual bankers shall be banks of discount and deposit, as well as of circulation," was an attempt to do away with these "circulation" banks. It seems, however, to have been ineffectual.¹

free banking law, since the passage of the Act of 1838, have not produced over 75 per cent. in cash, on their par value.

"The experience of sixteen years has, therefore, demonstrated the fact that bonds and mortgages do not prove to be a certain and ample security to bill holders, and it cannot be supposed that bonds and mortgages can be negotiated or converted into cash, on short notice, by the superintendent at their par value."

¹ It is believed that this provision of the law is in many cases entirely evaded. The quarterly reports received show that they are not banks of discount and deposit, having neither; or if they have, it is a mere nominal sum incorporated into their reports to comply with the form and not the spirit of the law.

They are mere banks of circulation, and are established for that purpose alone. The business of circulating their notes is done exclusively through agents and brokers in commercial cities distant from the location of the bank. In many instances, it is believed, the banker does not even sign the notes issued from this department and put in circulation, but gives that power to an agent. . . . In this manner are evaded the provisions of the law of 1848, which makes it obligatory for banks and bankers to transact their usual business at the places where they are located.

These banks afford no facilities to the business portion of the community, and in a time of pressure or embarrassment in the money market, not unfrequently allow their notes to be discredited, thereby creating a panic and subjecting the bill holders to losses.—*Report of Comptroller, 1851.*

Defects and Remedies.

Ten years' experience under the Safety Fund system made it possible to avoid from the very origin of the free banking system numerous mistakes which might otherwise have been involved. But even with this advantage the novel conditions resulting from the new legislation developed peculiar defects.

First.—It was found that the acceptance of public stocks other than those of New York, tended to create a market in New York, to serve as a basis for bank circulation, for stocks which were otherwise comparatively unsalable. As a consequence, when by the failure of banks depositing them State officials attempted to realize upon them, the result was disastrous, and note holders suffered heavy losses.

The following is a summary of the results of the sales of securities prior to January 1, 1849:

\$449,000 Indiana stock sold for	\$220,381.25, or 49.08 per cent	
239,000 Illinois stock sold for	117,423.25, " 49.13	"
176,000 Arkansas stock sold for	103,445.00, " 58.77	"
66,000 Michigan stock sold for	48,147.50, " 72.95	"
79,000 Alabama stock sold for	56,142.50, " 71.00	"
257,555 New York stock sold for	239,143.64, " 92.86	"
472,988 Bonds and Mortgages sold for	320,261.00, " 67.71	"
<hr/>		
\$1,739,543.	Total	\$1,104,944.14, " 63.51 "

Second.—A similar result attended the use of bonds with mortgage collateral as a basis for currency. On sudden forced sale, no matter how good the security, they were frequently sacrificed at less than their face. Again, it was found that ordinary precautions were not sufficient to insure a proper margin in steady value of real estate collateral above the bond to secure which it was mortgaged.

Third.—The business of currency issue being thus encouraged without reference to its connection with discount or other financial business, an incentive was offered to sanguine and visionary individuals to exploit their credit—with results scarcely less disastrous to themselves than to the community whose business they helped demoralize.

Fourth.—The law encouraged petty banking under more or less amateur management, with the resulting certainty of frequent petty failures however sound might be general conditions.

Fifth.—No adequate distinction was made between security and availability. The result was that any serious strain must force upon the market a large amount of securities, the sale of which below their par or valuation by the State officials was as inevitable as was the consequent result of somewhat of loss to note holders.

Sixth.—There was a tendency to rigidity of circulation. Though the securities accepted by the bank department were in general procurable at such rates as did not involve either large premiums or peculiarly low interest, yet any prompt response to legitimate demands for more currency was none the less obstructed. Experience elsewhere has shown that a 20 to 25 per cent increase in the wants of a community at one season of the year above those of another is not unusual or abnormal. For the banks to create a new investment demand for securities equal to one-fourth or one-fifth of their circulation would be as sure to involve somewhat of a rise in price as would the throwing of an equal amount of securities upon the market, when the currency was no longer needed, bring about a substantial depreciation. To make the process pay, interest upon the additional currency thus secured for the short time involved must be sufficient, not merely to provide compensatory interest, but to make up for the loss thus involved. In practice this was prohibitory, and increase of currency was ordinarily limited to such as might be obtained by the deposit of whatever securities a bank might happen to have; while the possession of securities involved a tendency to keep them on deposit at the Bank Department, and to take out the full amount of currency even during the season when there was little demand for it. The actual result was the natural one—a practical rigidity of free bank circulation—not, however, so great as has of late been the case under the National banking system, which the sacrifice involved in Government bond investments, and the effect of Federal legislation intentionally prescribing rigidity, has left a petrification.

Seventh.—There was an absolute lack of mutual support among the banks of the system. As a result, however it might be perfected without remedying this defect, from time to time, in individual cases, note holders would suffer petty losses. Experience showed that this was the case, and the uncertainty thus kept alive as to the safety of well-secured notes was much more serious than the actual loss suffered.

Remedies.

The *first* defect noted was corrected by the act of 1840, to which reference has already been made, restricting the State stocks admitted on deposit to those of the State of New York alone (even United States stocks not being accepted until 1849), and the earlier basis—a 5 per cent stock at par—having proved too high a rating, the act of 1848 raised the basis to 6 per cent. As to *second*, it was not until 1863 that the Legislature went so far as to discard mortgages altogether as a basis for circulation; but the terms upon which they might be accepted were

earlier made so strict as effectually to discourage their deposit. The *third* and *fourth* of the defects noted were to a certain extent corrected by the legislation of 1840 and 1844, requiring associations to deposit at least \$100,000, and individual bankers at least \$50,000, in approved securities before they could receive blank circulating notes.

As to the *fifth*, *sixth*, and *seventh* of the points noted above no reform was ever had. As to the margin of availability, a mere limitation of notes to be issued to say 90 or some other per cent less than par or official valuation would be perfectly easy, and if carried to the proper extent would meet the difficulty.

As to the comparative rigidity of the circulation, this is a defect involved in the system itself, and, with all its faults, is not without somewhat of compensation—though it seems generally agreed that the balance of considerations is against rigidity.

As to the *seventh* defect noted, the mutual support desirable to perfect in this regard the free banking system would have been so much less than that necessary in the Safety Fund system (where such mutual support was the main security offered) that it could have been, and probably would have been, provided in some one of numerous practicable ways, which would not have been complicated in administration or burdensome to the banks.

Results.

In the case of free banking, as earlier in the Safety Fund experience, legislation, to remedy such defects as were disclosed by experience, was on the whole prompt and effective.

It was during the first twelve years that were suffered most of the disasters which were afterward made impossible. Abstracting, as to banks which failed before 1850, the results . . . it is found that for twelve years, with an average circulation of \$6,000,000, the actual loss to note holders was for the whole period \$326,000, or \$27,200 per year—less than half of one per cent on the average circulation. For the latter period, 1851–65, the total failures resulted in an average loss of \$4,800 per annum upon an average circulation of \$22,000,000 outstanding; while the experience of the last few years seems to indicate that, with the exception of rare petty losses of a small part of the circulation of individual banks, there were no other losses against which to perfect the security of the system it was necessary to provide.

In its experimental days the Free Banking system had made but a poor showing in comparison with its Safety Fund rival,¹ but after it had

¹ In the security of the public under each system, our experience in the failure of ten Safety Fund banks, and about three times that number of free banks, proves that the contributions of half of one per cent annually on the capital of the Safety Fund banks, has thus

been perfected in the light of experiment, it was so nearly a secure system as to have been accepted with universal approval as the model upon which National banking should be planned.

The Indiana State Bank.

Adapted from an Article by L. Carroll Root in "Sound Currency Reform Club," 1895, pp. 231-232.

When Indiana was admitted as a State in 1816, there were in operation two banks chartered in 1814, one of which, the Bank of Vincennes, incorporated September 10, 1814, with a capital of \$500,000, was adopted as the State bank of Indiana, in accordance with the constitution which prohibited the establishment of any bank except a State bank, but provided in express terms that the existing banks might be consolidated into such State bank. By the provisions of the Act of adoption the powers of the incorporation were enlarged, and it was authorized to increase its banking facilities by additional \$1,000,000 capital divided into 10,000 shares of \$100 each. Of these shares, 3,750 were reserved to be subscribed for from time to time by the Governor of the State. The remainder were to be offered to private individuals, corporations and companies. The Bank of Vincennes was also authorized to affiliate the Farmers' and Mechanics' Bank of Indiana, at Madison, as one of its branches. Branches were also established at Brookville, Corydon and Vevay. In 1821, scarcely five years after the Bank of Vincennes had been raised to the dignity of a State bank, violations of the powers granted by its charter had become notorious. The Legislature, on December 31, 1821, authorized proceedings against it which resulted in its being deprived of its franchise and privileges. A large amount of its notes became utterly worthless, but those of the Farmers' and Mechanics' Bank were ultimately redeemed. The actual paid-in capital of both banks does not appear to have been more than \$202,857.¹

For the next thirteen years Indiana was without banks of any sort. "In 1834, the State Bank of Indiana was incorporated, with ten branches, afterward increased to thirteen, the branches being mutually liable for the debts of each other. Each share was subject to a tax of twelve and one-half cents annually for educational purposes, in lieu of all other taxes. If an *ad valorem* system of taxation should be author-

far afforded as much protection, as the deposit with the Comptroller, by the free banks, of a sum nominally equal to all the bills issued to them. It will be seen, by reference to a statement under the head of insolvent free banks, that the loss to bill holders, on the supposition that all the securities had been stocks of this State and bonds and mortgages, would have been over 16 per cent, while the actual loss has been nearly 39 per cent.—*Comptroller A. C. Flagg*, 1846.

¹J. J. Knox, in *Rhodes' Journal of Banking*, September, 1892.

ized by the State, the stock was to be liable the same as other capital, not exceeding one per cent per annum. The directors of the parent bank were to have charge of the plates and unsigned notes of the branches, and were authorized to deliver to them an amount of circulation not exceeding twice the amount of the stock subscribed.

"The State Bank was chartered, as were many other banks in different States, to fill the vacuum which it was anticipated would result from the winding up of the Bank of the United States. The parent bank itself was merely a Board of Control, the President and five Directors of which were elected by the Legislature. All the business was done by the branches, which were under supervision and control of the Central Board in much the same manner as the National Banks are under the supervision of the office of the Comptroller of the Currency. The branches each elected one director who formed a part of the Board of Control. The charter extended until January 1, 1857, and during the existence of the State Bank no other bank was to be created or authorized. The capital of each branch was \$160,000, one-half to be taken by the State and the other by individual stockholders. The whole capital was paid in silver. The State paid in its proportion at once. The individual stockholder paid in \$18.75 on each fifty-dollar share and the remaining \$31.25 was paid for him by the State upon his giving real estate security at one-half its improved value for the repayment. The money, to make its own payments and those advanced for the stockholders, was obtained by the State by the sale in London of its own 5 per cent bonds, which were known as bank bonds, the interest being provided for from the dividends of the State stock. All capital was thus paid in cash; each stockholder was liable for an amount equal to his stock, and each branch was liable for the debts of the other branches."¹

No note under \$5 was allowed to be issued, and the Legislature reserved the right to restrict it to \$10 within ten years.

In January, 1836, an amendment was passed by the Legislature, allowing the discounts to be extended to two and one-half times the capital, and permitting the branches to increase their capitals to \$250,000 each, though only four ever had over \$200,000.

The bank commenced business at one of the most critical periods in the history of the country, at the beginning of the era of speculation which nearly bankrupted the whole nation, and which culminated in the terrible catastrophe of 1837. At this disastrous crisis nearly every bank in the Western and Southwestern States failed, with the exception of the State Bank of Indiana. A very large number of those of the

¹ J. J. Knox, in *Rhodes' Journal of Banking*, September, 1892.

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Eastern States were totally ruined. The bank did, however, suspend specie payments in 1838. In 1841 it was authorized to issue notes of a less denomination than \$5, not exceeding in the aggregate \$1,000,000, on the payment of one per cent for the privilege. In 1839 its circulation was \$2,951,594, of which about one-third was notes of \$5 and the remainder mainly \$10 and \$20. In 1845, the total circulation was \$3,527,351, of which \$520,393 was notes below \$5.

STATEMENT OF THE CAPITAL, CIRCULATION, SPECIE, AND LOANS AND DISCOUNTS OF THE STATE BANK OF INDIANA.

	Branches	Capital	Circulation	Specie	Loans and Discounts
January 1, 1835...	9	\$800,000	\$456,065	\$751,083	\$531,843
May 13, 1837...	10	1,846,921	2,516,790	1,196,187	4,208,956
November, 1840...	12	2,071,618	2,805,568	1,076,551	3,689,595
" 1841...	12	2,743,191	2,871,689	1,127,901	4,419,104
" 1842...	12	2,727,532	1,828,371	811,234	2,866,629
" 1843...	12	2,130,555	2,310,690	965,226	2,677,530
" 1844...	12	2,105,212	3,101,000	1,120,013	2,834,421
" 1845...	12	2,087,894	3,527,351	1,079,368	3,721,805
" 1846...	12	2,083,824	3,336,533	1,003,647	3,596,391
" 1847...	12	2,082,874	3,606,452	1,083,970	3,498,912
" 1848...	12	2,089,908	3,708,031	1,273,895	3,551,544
" 1849...	12	2,082,910	3,304,200	1,285,406	3,912,796
" 1850...	13 ¹	2,082,950	3,421,445	1,197,880	4,395,099
" 1851...	13	2,083,007	3,772,193	1,245,407	4,621,726
" 1852...	13	2,083,007	3,860,524	1,308,933	4,249,994
" 1853...	13	2,150,107	3,835,705	1,377,805	5,037,394
" 1854...	13	2,150,107	2,803,648	1,086,963	4,198,585
" 1855...	13	2,150,107	3,335,726	1,223,199	4,678,781
" 1856...	13	2,150,107	3,381,806	1,119,469	4,690,636

The bank resumed specie payments in 1841, and thereafter, under able management, maintained a high credit, and when its charter expired in 1857 it was with deep regret on the part of many that the new constitution precluded its renewal upon the former basis.² But, influenced perhaps more by the disastrous failures of nearly every other banking institution under State management than by any shortcomings in the State Bank of Indiana, the people in 1851 had inserted in the State constitution the section: "The State shall not be a stockholder in any bank after the expiration of the present bank charter; nor shall the credit of the State ever be given or loaned in aid of any person, association or corporation."

For the \$1,000,000 invested by the State in the institution it had received as its profits fully \$3,500,000. Of the numerous enterprises

¹ Indianapolis, Lawrenceburg, Richmond, Madison, New Albany, Evansville, Vincennes, Bedford, Terre Haute, Lafayette, Fort Wayne, South Bend, Michigan City.

² The State Bank of Indiana, chartered in 1835, though given special privileges in that its notes were not required to be secured by the deposit of State stocks as were those of the "free banks" established at the preceding session, cannot be regarded as a State institution in the sense in which the term is used in this sketch.

in which the State of Indiana embarked—and, for that matter, of the numerous banking enterprises in which any of the States embarked—this seems to have been about the most successful.

Louisiana Bank Act of 1842.

Adapted from an Article by Horace White in "Sound Currency Reform Club," 1895, pp. 209-210.

The State of Louisiana had her full share of bank misery in 1837 and later. Her banks suspended specie payments, and so remained until 1842. In that year the State passed a banking law which was, in nearly all respects, a model for other States and countries.

The principal features of this law were the requirements (1) of a specie reserve equal to one-third of all its liabilities to the public; (2) the other two-thirds of its liabilities to be represented by commercial paper having not more than ninety days to run; (3) all commercial paper to be paid at maturity; and if not paid, or if an extension were asked for, the account of the party to be closed and his name to be sent to the other banks as a delinquent; (4) all banks to be examined by a board of State officers quarterly or oftener; (5) bank directors to be individually liable for all loans or investments made in violation of the law, unless they could show that they had voted against the same if present; (6) no bank to have less than fifty shareholders, having at least thirty shares each; (7) any director going out of the State for more than thirty days, or absenting himself from five successive meetings of the board, to be deemed to have resigned, and his vacancy to be filled at once; (8) no bank to pay out any notes but its own; (9) all banks to pay their balance to each other in specie every Saturday, under penalty of being immediately put in liquidation; (10) no bank to purchase its own shares or lend on its own shares more than thirty per cent of the market value thereof.

This law had one feature which cannot be approved. It allowed some loans to be made on mortgage security, but it restricted such loans to the bank's capital. No part of the deposits could be lent except on commercial paper maturing within ninety days. I judge that not many mortgage loans were made by the Louisiana banks, since none of them suspended in the panic of 1857, although most of the banks of the country were temporarily closed by that catastrophe. Mortgage loans are all right in themselves, but they are no part of the banking business. I think that the Louisiana Bank Act of 1842 was eminently scientific. It was the first law passed by any State requiring a definite amount of specie to be kept as a reserve. The Louisiana law required no pledged

security for the circulating notes of banks, nor did it put any limit on the amount of their issues. All this was covered, and amply covered, by requiring thirty-three per cent of specie against all liabilities, whether deposits or notes, the balance of the assets to be in mercantile paper having not more than ninety days to run.

Under this law, Louisiana became in 1860 the fourth State in the Union in point of banking capital and the second in point of specie holdings. I think, however, that the requirement of a thirty-three per cent reserve of coin (or, as we say now, of "lawful money") was excessive, and that the twenty-five per cent in larger cities and fifteen per cent in other places, required of national banks, is ample. It is a matter of history that the Louisiana Bank Act of 1842 was strictly and intelligently enforced until the city of New Orleans was captured during the Civil War.

Louisiana State Aid to Banking.

Adapted from an Article by L. Carroll Root in "Sound Currency Reform Club," 1895, pp. 240-241.

March 14, 1818, Louisiana had authorized a subscription of \$500,000 toward the capital of \$2,000,000 in the Louisiana State Bank. The State was to appoint six out of eighteen directors. The bank was required to pay a bonus of \$100,000 to the State, in consideration for which "the stock and real estate belonging to the said bank shall forever during the continuance of its charter be exempt from the payment of any State tax." Inasmuch as only \$100,000 was ever actually subscribed and as both bonus and exemption from taxation were also characteristic of subsequent charters to other banking institutions, this bank can hardly be considered as a State institution.

April 7, 1824, the Bank of Louisiana was chartered, with a capital of \$4,000,000, one-half of which was subscribed by the State. For the State subscription the issue of 5 per cent bonds was authorized at the rate of \$100 in bonds for every \$83.50 of stock, payable at intervals from ten to twenty-five years from their dates. These were to be sold by the bank for specie. The interest was to be paid from the dividends upon the bank stock, any deficiency that might occur being paid by the bank and charged to the account of the State. Of the thirteen directors six were to be appointed by the Governor on behalf of the State. Five branches were required to be opened.

In 1826 the General Assembly seems to have become provoked at the delay in declaring dividends and insisted upon the declaration of a dividend upon the State stock at least. The difficulty experi-

enced in controlling the institution led to the appointment of a seventh director on the part of the State and an act requiring semi-annual dividends of profits. In 1827 the profits accruing to the State were sufficient to permit \$300,931 of the bonds to be called in and paid, which was authorized by a resolution of March 24th of that year.

In 1844 the Treasurer of the State was authorized to sell 12,000 shares of the stock of the Bank of Louisiana for the purpose of raising funds to pay the bonds, \$1,200,000, falling due in 1844 and 1849. The bank itself purchased the bonds, becoming thereby obligated to redeem both series of bonds, which it punctually did. The remainder of the stock was also directed to be sold in 1844 for the purpose of meeting other bonds falling due.

In 1832 the State incorporated the Union Bank of Louisiana, with a capital of \$7,000,000. This was an institution established on precisely the same foundation as the Union Banks of Florida and Mississippi mentioned elsewhere. The subscribers of the stock paid in nothing, merely giving a mortgage to cover the amount of subscription; and the actual capital was derived from the proceeds of the \$7,000,000 bonds issued by the State for the purpose. Six of the twelve directors were appointed by the Governor on behalf of the State. The State reserved the right to borrow from the bank \$500,000 at interest, and each stockholder was entitled to a credit equal to one-half the amount of his shares. The State for its guaranty was to receive one-sixth of the profits of the institution. The bank seems to have been managed no better than the most of the property banks of the same style in operation in other States. It failed in 1842 with its assets in such shape that the collection of anything from them was a slow and difficult matter. The proceeds, as realized, were turned toward the payment of the interest and principal of the \$7,000,000 bonds issued by the State on behalf of the Bank. January 18, 1853, the Union Bank deposited with the treasurer \$21,000 to secure the State against any loss for twenty-one bonds not returned. These—the last of the issue—were afterward returned and canceled.

The State also issued, in aid of the Consolidated Association, bonds to the amount of \$2,004,000; and in aid of the Citizens' Bank, additional bonds to the amount of \$8,000,000, of which \$7,188,000 were finally sold. Both these institutions were upon precisely the same basis as the Union Bank, *i.e.*, the sale of the bonds issued by the State was to furnish the actual capital, and the stockholders were to secure their subscriptions by mortgages on real estate. In the case of the Consolidated Association, the State, for its guaranty, was considered

as stockholder for \$1,000,000. Dividends were to be declared only as the bonds were paid, and in the same proportion. The profits till then were to be retained as a sinking fund to meet the redemption of the bonds. The case was the same with the Citizens' Bank, except that the interest of the State in the net profits was one-sixth, as in the case of the Union Bank. Both these institutions were put in liquidation in 1842.

By 1858 the bonds issued by the State for the Citizens' Bank had been reduced from \$7,188,000 to \$5,300,000, for which the State still retained a first mortgage on the \$14,000,000 real estate of the stockholders mortgaged by them to secure their stock. In the years 1842-1848 \$1,000,000 had been raised by assessments upon the stockholders. In 1852 the Citizens' Bank was reorganized upon an entirely new basis, the distinctive feature of which was the separation of the bank into two departments—a banking department and a mortgage department. Immediately the banking department assumed an important place among the banking institutions of the State—its circulation reaching \$4,089,000 by January, 1860.

The State definitely renounced the banking business in its Constitution of 1852 by the clause: "The State shall not subscribe for the stock of, nor make a loan to, nor pledge its faith for the benefit of any corporation or joint stock company created or established for banking purposes."

From the following table can be gathered something of the course of these banks in respect to their circulation:

Date.	Circulation Louisiana Bank.	Circulation Union Bank.	Circulation Citizens' Bank.
July, 1835	\$751,987.00	\$1,428,045.00	.....
Jan. 23, 1837	841,190.00	1,476,445.00	\$372,110.00
Dec. 23, 1837	398,000.00	1,564,580.00	410,545.00
“ 3, 1838	141,742.00	967,410.00	161,995.00
Oct. 21, 1839	292,722.00	638,470.00	428,450.00
Feb. 1, 1840	261,747.50	964,630.00	308,725.00
Dec. 5, 1840	257,552.00	981,695.00	.....
Mar. 26, 1842	276,277.50	447,170.00	.....
Jan. 1, 1843	341,216.50	148,325.00	.....
“ 1, 1844	673,389.50	68,335.00	.....
“ 1, 1845	776,644.50	30,580.00	.....
June 1, 1845	998,565.50	29,445.00	.....
Apr. 25, 1846	1,351,509.00	27,010.00	.....
Jan., 1847	965,777.00	26,350.00	947,163.00
“ 1848	1,026,640.00	26,135.00	.....
Nov., 1848	1,126,782.00	26,005.00	246,975.00
“ 1849	1,222,217.00	25,935.00	11,176.00
Dec., 1850	852,909.00	25,795.00	11,061.00
Oct. 30, 1852	1,249,484.00	25,520.00	6,027.00

The Bank War.

The Following Account is adapted from Davis R. Dewey, "The Second United States Bank," in the Publications of the National Monetary Commission.

President Jackson attacked the bank in his first message to Congress in December, 1829. He said that the law creating the bank was unconstitutional and inexpedient and that the bank had not established a uniform and sound currency. The matter was considered by a committee of the House of Representatives which reported favorably to the bank.

In his second message in December, 1830, Jackson again attacked the bank and suggested as a substitute a bank with limited powers which would be a branch of the Treasury Department.

The bank asked for an extension of its charter for fifteen years with some changes:

1. Two officers to be appointed with authority to sign all notes of denominations less than \$100.
2. No branch bank draft or other bank paper in denominations less than \$50, not payable at the place where issued, to be put in circulation.
3. The notes which were made payable at one place only, to be received at any office if tendered in liquidation or payment of any balance, by any other incorporated bank.
4. Unlawful for the bank to hold any real estate except that necessary for transacting business.
5. Not more than two branches to be established in any one State.
6. The bank to pay an annuity of \$200,000 per annum for fifteen years.
7. The bank not to issue any notes of a less denomination than \$20.
8. The bank to report to the Secretary of the Treasury the names of stockholders who were not resident citizens, and on application of the treasurer of any State to transmit a list of stockholders residing in said State. (Pages 250-251.)

A bill granting the extension of charter passed both houses of Congress. President Jackson vetoed the bill, bringing forward many objections.

1. The bonus paid by the bank was altogether too small; the passage of the bill was equal to a gratuity to the holders of the stock due to the increase in its market value. . . .
2. The bill gave to the existing stockholders a prescriptive right to Government favor and did not open subscriptions to public competition.
3. The measure discriminated against private citizens, inasmuch as

notes of the branches were made legal tender if paid in by any incorporated State bank, but were not receivable except at the office of issue when offered by any private citizen. This did "not measure out equal justice to the high and low, the rich and poor."

4. The bill practically exempted from State tax that part of the stock which was owned by foreigners. . . .

5. The management would fall into the control of a few citizen stockholders; as foreigners were excluded from the directorate, and as more and more stock was transferred abroad under the exemption from taxation, it would be easy for a few "designing men" to secure control by monopolizing the stock at home. If the influence of the bank were thus "concentered," there would be "cause to tremble for the purity of our elections in peace and for the independence of our country in war." The bank should be "purely American."

6. The bank as proposed was unconstitutional. . . . The decision of the Supreme Court of the United States in the case *McCulloch v. Maryland*, according to Jackson, did not limit the authority either of Congress or the Executive. That opinion did not define whether a bank was necessary or not, but held that a bank was constitutional only if held to be necessary; it was therefore inferred that if the legislative branch held that the bank was unnecessary, it was unconstitutional.

7. There was suspicion that the bank had violated its charter, but notwithstanding this the bank had declined to demand the severest scrutiny of its transactions. (Pages 251-253.)

Dewey takes up the various charges as follows:

1. Political opposition at the time of Jackson's election had become bitter and many personal animosities had been aroused. The disposition of every public question was influenced by intense partisanship. It was only natural, therefore, that the bank should have to suffer in common with other questions of public policy. . . . But even if the bank be put to the test, the central management will stand exonerated. Catterall, who has made a most exhaustive investigation of this charge, having at command, beside the usual sources, Biddle's letterbooks and papers, declares that "it may be said at once that there has not been any evidence produced to show that the bank as a national bank ever spent a dollar corruptly." . . . (Pages 254-255.)

2. After the bank was attacked it did exercise certain pressure upon legislative bodies in order to support its cause. It maintained lobby agents and endeavored to secure the election of its advocates. For this it should be criticized, but in justice it must be remembered that this action was subsequent to the original attack and was prompted by the special plight in which the bank found itself. (Page 257.)

3. In conclusion, therefore, it may be said that until a political attack had been made upon it the central management of the bank kept itself singularly free from political activity. The branch management in some places was open to criticism, but any defect here could have been remedied in a great measure by a different relationship between the mother bank and the branches, and criticism on this point might well be directed against the plan of organization rather than against the principle. (Page 258.)

4. A second class of objections dealt more particularly with the operations of banking. The most important of these was directed against the use of branch drafts as a means of supplying the smaller denominations of currency. In the first place, it was claimed that their issue was contrary to law, and secondly, that they were harmful because they contracted the circulation of State banks. As to their legality, the bank rested on the opinion of able lawyers, Webster, Wirt, and Binney, secured in advance of the use of the drafts. This opinion was confirmed by a decision of the circuit court of the United States, 1831, which held that while the charter did not expressly authorize the officers of the bank to draw on the branches, it did not prohibit them from doing so. (Page 258.)

5. Whatever may be the merits or demerits of the use of branch drafts, there is no doubt that their employment was unfortunate for the bank; it gave the opposition a definite point of attack and undoubtedly increased the hostility of State institutions, which found their activity contracted. The bank, moreover, lent itself indirectly to an indorsement of the use of notes of small denominations, as low as \$5; this was a mistake, for at that time earnest efforts were made in many of the States to abolish all notes under that sum. The bank, of course, could not issue these smaller notes, because of the charter prohibition, but in throwing into circulation so large a number of \$5 drafts it apparently showed a lack of sympathy for the movement which was supported by the most conservative element in the country; it sacrificed a possible position of leadership in a needed reform for its own individual profit. (Pages 260-261.)

6. Other accusations involving illegal practices were: The charging of usury, sale of coin, trading in public securities, and speculation in real estate. The indictment on these points is in its final analysis of little importance, for, as a rule, the accusation under each heading referred to but a single action, which, if true, might well be regarded as exceptional. The bank had charged discount and exchange on domestic bills, thus obtaining in some cases more than the 6 per cent interest allowed by the charter. It was difficult, however,

to prove that this device, which was openly used by State banks in many sections to evade the usury laws, had been intentionally employed by the bank for illegal purposes. The bank did endeavor to develop its business in exchange, even though discount operations were contracted. This was particularly so in the West. As there was a strong prejudice against charges for exchange, the bank had to suffer in public estimation for operations which of themselves were entirely justifiable. (Page 261.)

7. Another charge related to speculation in public stocks. In 1834 the Treasury wished to pay off a part of the Government indebtedness represented by the 3 per cent stock. The bank was consequently notified that deposits would be withdrawn, but the demand came at an unfortunate time. Previous withdrawals for the retirement of the public debt had been large, and the bank had been taxed to the utmost to make the necessary contraction in its business in order to meet the plans of the Treasury. Biddle, therefore, offered to pay a quarter's interest on the stock, provided its retirement was postponed. The Treasury agreed to this. Unfortunately the agent, General Cadwalader, who was sent to London in order to secure from the holders of the 3 per cent stock, which was largely owned abroad, their consent to delay retirement and accept the responsibility of the bank for the payment of interest, permitted the banking house of the Barings, which carried through the negotiations, to deviate from this plan. The Barings bought outright the 3 per cent stock, and thus the bank indirectly became responsible for the purchase of Government securities. Although the arrangements made by Cadwalader and the Barings were disavowed by Biddle, the negotiations, coming at a time when the bank was under fire, gave critics ample opportunity for charging the bank with trickery and a high-handed purpose of defeating the Government in its efforts to extinguish the debt.

8. The dealings of the bank in real estate admit of easy explanation. During the earlier and more speculative period of the bank's operations, the branch at Cincinnati was obliged to take a large amount of real estate in settlement of indebtedness; the sale of this was slow and the bank found it necessary to improve some of the property in order to secure any sale at all. For many years, therefore, the bank was both landlord and purchaser. All the evidence, however, goes to show that the bank made every possible effort to get rid of this dead asset and convert it into more active funds. (Pages 261-263.) . . . Biddle was a large figure in the contest. Catterall's characterization is accurate and instructive: "Nicholas Biddle was a man of intense energy, autocratic in temper, and possessing supreme confidence in his own judgment.

It was inevitable he should rule and not merely reign, and the proofs that he did rule are observable everywhere. He appointed the committees of the bank after 1828, though the rules giving him this power were not adopted until 1833; he does not want the bank's books examined by the government directors and he gives orders that the books must not be examined by them, though only the board could rightfully do this." . . . (Pages 263-264.)

Aside from these specific criticisms, opposition to the bank was inspired by political intrigue and by selfish jealousy of State banks. Many were convinced that Clay, who was a candidate for the Presidency in 1832, was behind Biddle in forcing the bank question to the front, in order to secure political capital. There is reason to believe that Clay foresaw a veto from Jackson, and on that issue thought he could successfully appeal to the country in the autumn elections. Biddle was also of this opinion and declared that Jackson's veto exhibited "all the fury of a chained panther biting the bars of his cage."

9. Clay mistook the temper of the voters. Aside from the opposition to the bank, there were other qualities in Jackson's administration which commanded the confidence of the people. There was a general approval of his position on the tariff and monopolistic corporations. Jackson was re-elected and interpreted this as a popular indorsement of his position on the bank. The next step was the removal of the deposits, even at the cost of dismissing a Cabinet secretary. The bank, on its side, was provoked into imprudent acts, which added to the bitterness of feeling; compromise was impossible, and the contest became a war of extermination. The history of this later period therefore is a record of recrimination and counter recrimination; of investigations which settled nothing; and finally of denunciatory resolutions and efforts to expunge resolutions. Biddle, the successful bank president, engaged in daring and imprudent speculations, and the bank, in order to continue its existence, secured a charter from the State of Pennsylvania under terms which meant either legislative corruption or a most astonishing ignorance of the fundamental conditions of sound banking.

10. A second source of hostility to the bank is to be found in the opposition of local banks; this was not universal, but it was strong enough in some States to be an important factor. Especially was this so in New York; a considerable part of the national revenue was paid into the branch of the bank at New York City, and was consequently under control of the mother bank at Philadelphia. The State banks naturally desired these deposits and used their influence to arouse antagonism to the bank and indorsement of Jackson's policy. (Pages 264-265.)

Suggested Readings on Chapter XII.

Dewey, D. R.—State Banking Before the Civil War.

Barnett, G. E.—State Banks and Trust Companies since the
Passage of the National Bank Act.

Phillips, C. A.—Readings in Money and Banking.

Moulton, H. G.—Financial Organization. Principles of
Money and Banking, Part II, Chapter VI.

Willis, H. P.—American Banking, Chapters XIII and XIV.

White, H.—Money and Banking.

Questions and Problems on Chapter XII.

1. How can a government which does not regulate banking be said to take some interest in banking?
2. If a measure failed 50 years ago, under what circumstances can we predict that it would fail to-day?
3. Should the form of organization be decisive in the matter of regulation or the character of the business? Why do private banks often escape regulation?
4. What advantages arise when it is easy to get a bank charter and local people organize the banks? What disadvantages?
5. Distinguish between ultimate and immediate redemption of bank notes. Which is the more important in securing a sound note system?
6. Why are not other forms of wealth just as good as cash for the capital of a bank?
7. What is the purpose of a minimum capital requirement? Under what conditions is population not an indication of the volume of business?
8. Is it safe to argue that the larger the bank, the better the management?
9. If the reserve needed depends on so many factors and varies so widely, from time to time, how can the law prescribe the reserve which should be kept?
10. Can a law like the Louisiana law really make directors take a personal interest in the bank? Can you suggest a better law or some other means of achieving the end?
11. Under the Indiana bank system, each branch was responsible for the losses of the other branches but did not share its profits. Would it not have been better to have required them to share their profits and suffer their own losses?
12. What is the danger involved in laying down too rigid requirements for bank directors?
13. Is a bank ever justified in renewing a customer's note?
14. What features of a big bank with government participation make it particularly liable to be attacked by demagogues?
15. What was the objection to using mortgages as security for the notes issued by the New York free banks?
16. The United States Government subscribed to the capital of both the First and Second United States Banks, but

not to the capital of the Federal reserve banks. Why this discrimination?

17. Why did the public generally sympathize with the banks in new sections of the country in their refusal to redeem their notes.

18. What is the disadvantage to trade of a system of bank notes with merely local circulation?

19. Why, under the safety fund system, could a bank known to be insolvent sell its notes?

20. How could the Suffolk Bank afford to handle the vast quantities of notes sent in?

21. Why did the notes of the country banks drive the notes of the Boston banks out of circulation?

22. Why were there so many losses when the New York free banking system of note issue was tried in the Western States?

23. Why were the issues of the New York safety fund banks more elastic than those of the free banks?

24. Suggest a method for preventing the unauthorized issues of notes which took place under the New York Safety Fund System.

25. Was the bank or Jackson or somebody else to blame for "The Bank War"?

26. Contrast the steps by which more money would get into circulation to meet the demands of increasing business under a system of government issue and of bank issue.

CHAPTER XIII.

THE NATIONAL BANKING SYSTEM.

The national banking system was started in 1863 to provide a uniform currency and to help sell Government bonds.

Provisions of the Act.

1. Charters.

These are obtained from the National Government. The bank must have five incorporators. The Comptroller of the Currency, before he grants the certificate, makes sure that the incorporators are of proper character and experience, and that the proposed bank is really needed.

2. Capital.

The amount of capital required varies with the population:

<i>Population in thousands.</i>	<i>Capital required.</i>
Up to 3	\$25,000
3 to 6	50,000
6 to 50	100,000
Over 50	200,000

Fifty per cent of the capital must be paid in cash before the bank starts, and the balance in five monthly installments.

3. Notes.

Formerly, each bank was required to invest part of its capital in Government bonds against which it might issue notes. Now the holding of bonds is optional. Notes may be issued to the amount of the capital of the bank by the deposit of the United States bonds which have the circulation privilege. Notes may be issued to the amount of the market value, but not more than the par value of the bonds. The bank holds 5 per cent of the outstanding notes in the United States Treasury in lawful money to redeem the notes.

4. Loans.

The banks can loan only to a limited extent on real estate

To insure distribution of risk, the amount they can loan to one individual is restricted.

5. Surplus.

The bank must set aside one-tenth of its earnings for surplus until it becomes 20 per cent of its capital.

6. Reserves.

In addition to the amount of cash they hold in their own vaults to meet the demands of their customers, the national banks must hold balances in the Federal reserve banks. All must hold 3 per cent of their time deposits. On demand deposits, banks in central reserve cities (New York and Chicago) hold 13 per cent; in reserve cities, 10 per cent; and in other places, 7 per cent.

7. Supervision.

The banks must make five reports of condition each year, at unexpected dates. A summary of the report must be published in a newspaper. Twice a year the bank is examined without notice.

Advantages of State Banks over National Banks.

1. The minimum capital is usually lower.
2. No bond deposit is required (formerly).
3. Some States allow branches.
4. Reserve requirements are often lower.
5. Regulation is not so strict.

Advantages of National Banks Over State Banks.

1. They can issue notes.
2. They can receive United States Government deposits.
3. They enjoy the prestige of a national charter.

Materials on Chapter XIII.**Brief History of the National Banking System.**

Salmon P. Chase, Secretary of the Treasury at the time, was responsible for the founding of the national banking system. Specie payments had been suspended December 30, 1861, leaving only State bank notes in circulation. Later the greenbacks were issued but they were supposed to be only temporary. The reasons for founding the new system were: (1) to provide a sound and uniform currency; (2) to establish a market for United States bonds.

The bill was passed February 25, 1863. Not many banks were formed under the first act, so a revision was passed June 3, 1864, which remedied some of the features to which the banks objected.

The banks were chartered by the Federal Government. No bank was allowed to start with less than \$100,000 capital, except in places of 6,000 or less population, where the capital might be \$50,000. One-half of the capital was required to be paid in before the bank started. The bank was forced to buy Government bonds in the amount of one-third of its capital and equal at least to \$30,000, and deposit them with the newly created Comptroller of the Currency. Circulating notes could be issued to 90 per cent of the market value of the bonds but not more than 90 per cent of the par value of the bonds. Reserves were to be held by banks against notes and deposits: 25 per cent in central reserve cities; 25 per cent in reserve cities, but one-half might be held on deposit in the central reserve cities; 15 per cent in country banks, three-fifths of which might be deposited in central reserve or reserve cities.

In 1874 in place of the reserve against notes the banks were required to keep a 5 per cent redemption fund with the Treasurer of the United States.

The amount of circulation was limited to \$300,000,000; one-half was to be apportioned according to population and one-half according to the business of the communities. This proved to be a difficult feature of the law to administer and after several changes in the law, with the resumption act of 1875, there was no further restriction on the amount of notes that could be issued.

In general, the circulation outstanding increased until the '80s, when the price of Government bonds became so high that it was no longer profitable for the banks to issue notes.

After the further issue of bonds in the '90s, more notes were issued. Still more resulted from the act of 1900. This permitted banks to be started with a capital of \$25,000 in places of 3,000 population. Banks were allowed to issue 100 per cent instead of 90 per cent of the value of

the bonds. Provision was made for 2 per cent bonds which would presumably sell near par.

At first the system grew very slowly. In January, 1864, there were only 139 national banks. The act of 1865 levied a tax of 10 per cent on notes of a State bank paid out by any bank after July 1, 1866. Since the banks at that time thought that note issuing was important, large numbers became national banks.

Laws Concerning National Banks.

See also the Federal Reserve Act, Sections 2, 5, 9, 11(k), 13, 19, 20, 23, 24, 25, 25(a), 28.

ACT OF MARCH 14, 1900.

CHAP. 41.—*An act to define and fix the standard of value, to maintain the parity of all forms of money issued or coined by the United States, to refund the public debt, and for other purposes.*

* * * * *

SEC. 10. That section fifty-one hundred and thirty-eight of the Revised Statutes is hereby amended so as to read as follows:

"Section 5138. No association shall be organized with a less capital than one hundred thousand dollars, except that banks with a capital of not less than fifty thousand dollars may, with the approval of the Secretary of the Treasury, be organized in any place the population of which does not exceed six thousand inhabitants, and except that banks with a capital of not less than twenty-five thousand dollars may, with the sanction of the Secretary of the Treasury, be organized in any place the population of which does not exceed three thousand inhabitants. No association shall be organized in a city the population of which exceeds fifty thousand persons with a capital of less than two hundred thousand dollars."

* * * * *

SEC. 12. That upon the deposit with the Treasurer of the United States, by any national banking association, of any bonds of the United States in the manner provided by existing law, such association shall be entitled to receive from the Comptroller of the Currency circulating notes in blank, registered and countersigned as provided by law, equal in amount to the par value of the bonds so deposited; and any national banking association now having bonds on deposit for the security of circulating notes, and upon which an amount of circulating notes has been issued less than the par value of the bonds, shall be entitled, upon due application to the Comptroller of the Currency, to receive addi-

tional circulating notes in blank to an amount which will increase the circulating notes held by such association to the par value of the bonds deposited, such additional notes to be held and treated in the same way as circulating notes of national banking associations heretofore issued, and subject to all the provisions of law affecting such notes: *Provided*, That nothing herein contained shall be construed to modify or repeal the provisions of section fifty-one hundred and sixty-seven of the Revised Statutes of the United States, authorizing the Comptroller of the Currency to require additional deposits of bonds or of lawful money in case the market value of the bonds held to secure the circulating notes shall fall below the par value of the circulating notes outstanding for which such bonds may be deposited as security: *And provided further*, That the circulating notes furnished to national banking associations under the provisions of this act shall be of the denominations prescribed by law, except that no national banking association shall, after the passage of this act, be entitled to receive from the Comptroller of the Currency, or to issue or reissue or place in circulation, more than one-third in amount of its circulating notes of the denomination of five dollars: *And provided further*, That the total amount of such notes issued to any such association may equal at any time but shall not exceed the amount at such time of its capital stock actually paid in: *And provided further*, That under regulations to be prescribed by the Secretary of the Treasury any national banking association may substitute the two per centum bonds issued under the provisions of this act for any of the bonds deposited with the Treasurer to secure circulation or to secure deposits of public money; and so much of an act entitled "An act to enable national banking associations to extend their corporate existence, and for other purposes," approved July twelfth, eighteen hundred and eighty-two, as prohibits any national bank which makes any deposit of lawful money in order to withdraw its circulating notes from receiving any increase of its circulation for the period of six months from the time it made such deposit of lawful money for the purpose aforesaid, is hereby repealed, and all other acts or parts of acts inconsistent with the provisions of this section are hereby repealed.

SEC. 13. That every national banking association having on deposit, as provided by law, bonds of the United States bearing interest at the rate of two per centum per annum, issued under the provisions of this act, to secure its circulating notes, shall pay to the Treasurer of the United States, in the months of January and July, a tax of one-fourth of one per centum each half year upon the average amount of such of its notes in circulation as are based upon the deposit of said two per centum bonds; and such taxes shall be in lieu of existing taxes on its

notes in circulation imposed by section fifty-two hundred and fourteen of the Revised Statutes.

* * * * *

Approved, March 14, 1900.

REVISED STATUTES OF THE UNITED STATES.

Tax on Notes of Persons or State Banks Used for Circulation.

SEC. 3412. Every national banking association, State bank, or State banking association, shall pay a tax of ten per centum on the amount of notes of any person, or of any State bank or State banking association, used for circulation and paid out by them.

Formation of National Banking Associations.

SEC. 5133. Associations for carrying on the business of banking under this Title may be formed by any number of natural persons, not less in any case than five. They shall enter into articles of association, which shall specify in general terms the object for which the association is formed, and may contain any other provisions, not inconsistent with law, which the association may see fit to adopt for the regulation of its business and the conduct of its affairs. These articles shall be signed by the persons uniting to form the association, and a copy of them shall be forwarded to the Comptroller of the Currency, to be filed and preserved in his office.

Requisites of Organization Certificate.

SEC. 5134. The persons uniting to form such an association shall, under their hands, make an organization certificate, which shall specifically state:

First. The name assumed by such association; which name shall be subject to the approval of the Comptroller of the Currency.

Second. The place where its operations of discount and deposit are to be carried on, designating the State, Territory, or district, and the particular county and city, town, or village.

Third. The amount of capital stock and the number of shares into which the same is to be divided.

Fourth. The names and places of residence of the shareholders and the number of shares held by each of them.

Fifth. The fact that the certificate is made to enable such persons to avail themselves of the advantages of this Title.

How Certificate Shall Be Acknowledged and Filed.

SEC. 5135. The organization certificate shall be acknowledged before a judge of some court of record, or notary public; and shall be, together with the acknowledgment thereof, authenticated by the seal of such court, or notary, transmitted to the Comptroller of the Currency, who shall record and carefully preserve the same in his office.

How Payment of the Capital Stock Must Be Made and Proved.

SEC. 5140. At least fifty per centum of the capital stock of every association shall be paid in before it shall be authorized to commence business; and the remainder of the capital stock of such association shall be paid in installments of at least ten per centum each, on the whole amount of the capital, as frequently as one installment at the end of each succeeding month from the time it shall be authorized by the Comptroller of the Currency to commence business; and the payment of each installment shall be certified to the Comptroller, under oath, by the president or cashier of the association.

Individual Liability of Shareholders.

SEC. 5151. The shareholders of every national-banking association shall be held individually responsible, equally and ratably, and not one for another, for all contracts, debts, and engagements of such association, to the extent of the amount of their stock therein, at the par value thereof, in addition to the amount invested in such shares.

Certificate of Authority to Commence Banking to Be Issued.

SEC. 5169. If, upon a careful examination of the facts so reported, and of any other facts which may come to the knowledge of the Comptroller, whether by means of a special commission appointed by him for the purpose of inquiring into the condition of such association, or otherwise, it appears that such association is lawfully entitled to commence the business of banking, the Comptroller shall give to such association a certificate, under his hand and official seal, that such association has complied with all the provisions required to be complied with before commencing the business of banking, and that such association is authorized to commence such business. But the Comptroller may withhold from an association his certificate authorizing the commencement of business, whenever he has reason to suppose that the shareholders have formed the same for any other than the legitimate objects contemplated by this Title.

Reports to Comptroller of the Currency.

SEC. 5211. Every association shall make to the Comptroller of the Currency not less than five reports during each year, according to the form which may be prescribed by him, verified by the oath or affirmation of the president or cashier of such association, and attested by the signature of at least three of the directors. Each such report shall exhibit, in detail and under appropriate heads, the resources and liabilities of the association at the close of business on any past day by him specified; and shall be transmitted to the Comptroller within five days after the receipt of a request or requisition therefor from him, and in the same form in which it is made to the Comptroller shall be published in a newspaper published in the place where such association is established, or if there is no newspaper in the place, then in the one published nearest thereto in the same county, at the expense of the association; and such proof of publication shall be furnished as may be required by the Comptroller. The Comptroller shall also have power to call for special reports from any particular association whenever in his judgment the same are necessary in order to a full and complete knowledge of its condition.

Report of the National Monetary Commission, January 9, 1912.
pp. 6-9.

The act of May 30, 1908, providing for the appointment of the National Monetary Commission was a direct consequence of the panic of 1907. We shall not attempt to recount the severe losses and misfortunes suffered by the American people of all classes as the result of this and similar crises. To seek for means to prevent the recurrence or to mitigate the severity of grave disasters of this character was, however, one of the primary purposes of its creation.

We have made a thorough study of the defects of our banking system, which were largely responsible for these disasters, and have sought to provide effective remedies for these and other defects, in the legislation we propose.

The principal defects in our banking system we believe may be summarized as follows:

1. We have no provision for the concentration of the cash reserves of the banks and for their mobilization and use wherever needed in times of trouble. Experience has shown that the scattered cash reserves of our banks are inadequate for purposes of assistance or defense at such times.

2. Antiquated Federal and State laws restrict the use of bank reserves and prohibit the lending power of banks at times when, in the presence of unusual demands, reserves should be freely used and credit liberally extended to all deserving customers.

3. Our banks also lack adequate means available for use at any time to replenish their reserves or increase their loaning powers when necessary to meet normal or unusual demands.

4. Of our various forms of currency the bank-note issue is the only one which we might expect to respond to the changing needs of business by automatic expansion and contraction, but this issue is deprived of all such qualities by the fact that its volume is largely dependent upon the amount and price of United States bonds.

5. We lack means to insure such effective co-operation on the part of banks as is necessary to protect their own and the public interests in times of stress or crisis. There is no co-operation of any kind among banks outside the clearing-house cities. While clearing-house organizations of banks have been able to render valuable services within a limited sphere for local communities, the lack of means to secure their co-operation or affiliation in broader fields makes it impossible to use these or similar local agencies to prevent panics or avert calamitous disturbances affecting the country at large. These organizations have, in fact, never been able to prevent the suspension of cash payments by financial institutions in their own localities in cases of emergency.

6. We have no effective agency covering the entire country which affords necessary facilities for making domestic exchanges between different localities and sections, or which can prevent disastrous disruption of all such exchanges in times of serious trouble.

7. We have no instrumentality that can deal effectively with the broad questions which, from an international standpoint, affect the credit and status of the United States as one of the great financial powers of the world. In times of threatened trouble or of actual panic these questions, which involve the course of foreign exchange and the international movements of gold, are even more important to us from a national than from an international standpoint.

8. The lack of commercial paper of an established standard, issued for agricultural, industrial, and commercial purposes, available for investments by banks, leads to an unhealthy congestion of loanable funds in great centers and hinders the development of the productive forces of the country.

9. The narrow character of our discount market, with its limited range of safe and profitable investments for banks, results in sending the surplus money of all sections, in excess of reserves and local demands,

to New York, where it is usually loaned out on call on Stock Exchange securities, tending to promote dangerous speculation and inevitably leading to injurious disturbances in reserves. This concentration of surplus money and available funds in New York imposes upon the managers of the banks of that city the vast responsibilities which are inherent in the control of a large proportion of the banking resources of the country.

10. The absence of a broad discount market in our system, taken together with the restrictive treatment of reserves, creates at times when serious financial disturbances are anticipated a condition of dependence on the part of individual banks throughout the country, and at the same time places the farmers and others engaged in productive industries at a great disadvantage in securing the credit they require for the growth, retention, and distribution of their products.

11. There is a marked lack of equality in credit facilities between different sections of the country, reflected in less favored communities, in retarded development, and great disparity in rates of discount.

12. Our system lacks an agency whose influence can be made effective in securing greater uniformity, steadiness, and reasonableness of rates of discount in all parts of the country.

13. We have no effective agency that can surely provide adequate banking facilities for different regions promptly and on reasonable terms to meet the ordinary or unusual demands for credit or currency necessary for moving crops or for other legitimate purposes.

14. We have no power to enforce the adoption of uniform standards with regard to capital, reserves, examinations, and the character and publicity of reports of all banks in the different sections of the country.

15. We have no American banking institutions in foreign countries. The organization of such banks is necessary for the development of our foreign trade.

16. The provision that national banks shall not make loans upon real estate restricts their power to serve farmers and other borrowers in rural communities.

17. The provision of law under which the Government acts as custodian of its own funds results in irregular withdrawals of money from circulation and bank reserves in periods of excessive Government revenues, and in the return of these funds into circulation only in periods of deficient revenues. Recent efforts to modify the Independent Treasury system by a partial distribution of the public moneys among national banks have resulted, it is charged, in discrimination and favoritism in the treatment of different banks.

Number and Capital of Commercial Banks of the United States, 1867-1909.

From National Monetary Commission Statistics of Banks and Banking in the United States, p. 21.

[For dates nearest June 30.]

Year—	Number of—				Capital (including surplus).			
	National banks. ^a	State banks. ^a	Trust companies. ^a	Private banks. ^a	National banks.	State banks.	Trust companies.	Private banks.
					Millions.	Millions.	Millions.	Millions.
1867.....	1,636	272			\$481.7	b \$65.2		
1868.....	1,640	247			495.9	b 66.3		
1869.....	1,619	259			504.8	b 66.9,		
1870.....	1,612	325			518.9	b 86.5		
1871.....	1,723	452			548.6	b 111.4		
1872.....	1,853	566			575.7	122.1		
1873.....	1,968				606.9	44.8		
1874.....	1,983				617.2	62.2		
1875.....	2,076	551	35		634.7	75.8	\$28.8	
1876.....	2,091	633	38		682.2	87.4	29.8	
1877.....	2,078	592	39		605.7	116.6	29.5	
1878.....	2,056	475	35	c 2,856	588.5	103.2	30.0	b \$77.8
1879.....	2,048	616	32	c 2,634	569.5	120.8	28.8	b 69.7
1880.....	2,076	d 620	d 30	c 2,802	574.0	109.6	24.7	b 76.1
1881.....	2,115	652	31	c 3,038	586.9	113.9	26.0	b 93.3
1882.....	2,239	672	32	c 3,391	608.2	114.9	29.9	b 114.2
1883.....	2,417	754	34	c 3,412	638.6	128.3	31.6	b 105.3
1884.....	2,625	817	35		668.2	141.5	34.1	
1885.....	2,689	975	40		672.8	156.0	37.1	
1886.....	2,849	849	42		702.5	137.4	49.3	
1887.....	3,014	1,413	58	1,001	744.0	179.5	52.1	52.3
1888.....	3,120	1,403	120	1,203	771.5	196.3	77.3	50.4
1889.....	3,239	1,671	120	1,324	802.7	214.7	85.0	46.3
1890.....	3,484	2,101	149	1,344	854.6	240.6	105.2	50.5
1891.....	3,652	2,572	171	1,235	900.1	268.6	117.7	45.7
1892.....	3,759	3,191	168	1,161	922.9	300.5	126.4	42.3
1893.....	3,807	3,579	228	848	934.9	325.0	145.2	32.4
1894.....	3,770	3,586	224	904	916.8	318.8	154.7	32.6
1895.....	3,715	3,774	242	1,070	906.0	324.5	173.1	40.4
1896.....	3,689	3,708	260	824	899.5	310.8	173.5	27.3
1897.....	3,610	3,857	251	759	878.5	306.0	175.8	23.2
1898.....	3,582	3,965	246	758	869.3	314.9	171.8	19.8
1899.....	3,583	4,191	260	756	853.0	310.4	184.0	16.7
1900.....	3,732	4,369	290	989	877.7	328.4	239.5	22.5
1901.....	4,165	4,983	334	917	919.9	358.6	256.9	23.0
1902.....	4,535	5,397	417	1,039	1,027.5	388.3	329.6	28.9
1903.....	4,939	5,962	531	1,174	1,102.5	431.9	455.0	27.8
1904.....	5,331	6,923	585	854	1,157.0	500.7	492.3	22.1
1905.....	5,668	7,794	683	1,028	1,205.0	534.2	524.4	29.4
1906.....	6,053	8,862	742	929	1,275.0	592.7	616.6	26.3
1907.....	6,429	9,967	794	1,141	1,418.4	664.2	645.4	32.4
1908.....	6,824	11,220	842	1,007	1,483.1	719.6	648.5	26.7
1909 ^f	6,893	11,319	1,079	1,497	1,521.1	568.7	714.4	37.9

^a Number reporting to Comptroller of Currency.

^b Surplus not stated.

^c Number reporting to Commissioner of Internal Revenue.

^d Total number State banks and trust companies reporting capital but not surplus to Commissioner of Internal Revenue in 1880 was 996. (See Comptroller's Report 1880, p. lxxxvi.)

^e November 30, 1882: Law imposing tax upon capital and deposits of banks repealed March 3, 1883; no reports from private banks after first-mentioned date until 1887.

^f From special reports of April 28, 1909, obtained for the National Monetary Commission.

Number and Capital of Commercial Banks of the United States,
1910-1921.

From the Statistical Abstracts of the United States for Various Years.

Year	National banks ¹	Number of			Capital (including surplus)			
		State banks ²	Trust Co's. ³	Private banks ⁴	National banks millions	State banks millions	Trust Co's. millions	Private banks millions
1910	7173	12166	1089	934	\$1651.0	\$623.4	\$800.1	\$25.4
1911	7301	12843	1251	1116	1695.4	623.5	786.2	29.2
1912	7397	13381	1410	1091	1747.0	636.4	843.3	31.7
1913	7488	14011	1515	1016	1781.6	679.4	897.7	27.5
1914	7538	14512	1564	1064	1784.4	715.0	908.8	33.5
1915	7613	14598	1664	1036	1791.5	725.1	927.5	29.0
1916	7589	15450	1606	1014	1799.0	832.3	984.7	23.6
1917	7638	15968	1608	1036	1859.4	888.7	1040.3	24.1
1918	7728	16596	1669	1091	1915.6	962.8	1068.3	28.4
1919	7821	17215	1377	1017	2024.1	1226.6	942.5	28.7
1920	8093	18195	1408	799	2244.2	1447.2	985.7	26.4
1921	8155	18875	1474	708	2303.6	1642.9	1053.6	24.2

¹ The figures for the national banks are for reports near September 1st, each year; for the other banks, for reports about June 30th of each year.

² A few states include savings banks and trust companies.

³ A few states do not list separately.

⁴ Included in a few States with state banks.

National Bank Failures.

*From the Report of the Comptroller of the Currency for 1921,
pp. 89-90.*

Thirty-four national banks, with aggregate capital of \$1,870,000, were placed in charge of receivers during the year ended October 31, 1921. The date that each bank was authorized to commence business, date of appointment of the receiver, the capital stock, and the circulation outstanding at date of failure are shown in table No. 27, in the appendix of this report.

The first failure of a national bank took place in 1865; from that date until the close of business on October 31, 1921, the number of banks placed in charge of receivers was 628. Of this number, however, 40 were subsequently restored to solvency and permitted to resume business. The total capital of these failed banks was \$98,120,920, while the book or nominal value of the assets administered by receivers under the supervision of the Comptroller aggregated \$423,884,689, and the total cash, thus far realized from the liquidation of these assets, amounted to \$213,204,717. In addition to this amount, however, there has been realized from assessments of \$97,984,290, levied against shareholders, the sum of \$25,064,767, making the total cash collections from all sources \$238,269,484, which have been disbursed as follows:

In dividends to creditors on claims proved, amounting to \$219,930,162, the sum of.....	\$165, 109, 759
In payment of loans and other disbursements discharging liabilities of the bank other than those of the general creditors.....	49, 795, 024
In payment of legal expenses incurred in the administration of such receiverships.....	6, 144, 024
In payment of receivers' salaries and other expenses of receiverships....	10, 933, 718
There has been returned to shareholders in cash.....	3, 789, 079
Leaving a balance with the Comptroller and the receivers of.....	2, 497, 880
Total.....	238, 269, 484

In addition to the funds thus distributed there has been returned to agents for shareholders, to be liquidated for their benefit, assets having a nominal value of \$15,818,008.

The book or nominal value of the assets of the 61 national banks that are still in charge of receivers amount to \$62,417,919. The receivers had realized from these assets at the close of business on October 31, 1921, the sum of \$29,550,393, and had collected from the shareholders on account of assessments levied against them to cover deficiencies in assets the further sum of \$2,133,226, making the total collections from all sources in the liquidation of active receiverships the sum of \$31,683,619, which amount has been distributed as follows:

Dividends to creditors (to Sept. 30, 1921).....	\$20, 432, 266
Loans paid and other disbursements discharging liabilities of the bank other than those to the general creditors.....	6, 992, 900
Legal expenses.....	631, 365
Receivers' salaries and all other expenses of administration.....	1, 163, 836
Amount returned to shareholders in cash.....	4, 246
Leaving a balance with the Comptroller and the receivers of.....	2, 459, 006
Total.....	31, 683, 619

The receiverships of three national banks, which had failed in previous years were finally closed during the year ended October 31, 1921, making a total of 567 closed receiverships.

The collections from the assets of the 567 national banks, the affairs of which have been finally closed, amounted to \$183,654,324, and, together with the collections of \$22,931,541 from assessments levied against the shareholders, make a total of \$206,585,865, from which on claims aggregating \$187,313,581 dividends were paid amounting to \$144,677,493.

The average rate of dividends paid on claims proved was 77.25 per cent, but including offsets allowed, loans paid and other disbursements with dividends, creditors received on an average 83.79 per cent.

The expenses incident to the administration of these 567 trusts—that is, receivers' salaries and legal and other expenses—amounted to \$15,282,541, or 4.23 per cent of the nominal value of the assets and 7.40 per cent of the collections from assets and from shareholders. The outstanding circulation of these banks at the date of failure was \$28,704,904, which was secured by United States bonds on deposit in the Treasury of the face value of \$30,958,550. The assessments against shareholders averaged 51.34 per cent of their holdings, while the collections from the assessments levied were 48.49 per cent of the amount assessed. The total amount disbursed in dividends during the current year to the creditors of insolvent banks was \$1,216,835.

In the table following is summarized the condition of all insolvent national banks, the closed and active receiverships being shown separately:

Items.	Closed receiverships, 567. ¹	Active receiverships, 61.	Total, 628. ¹
Total assets taken charge of by receivers.....	\$361,466,770	\$62,417,919	\$423,884,689
Disposition of assets:			
Collected from assets.....	183,654,324	29,550,393	213,204,717
Offset allowed and settled.....	32,599,171	6,086,376	38,685,547
Loans on assets compromised or sold under order of court.....	125,199,491	6,724,969	131,924,460
Nominal value of assets returned to shareholders.....	15,818,008		15,818,008
Nominal value of remaining assets.....	4,204,776	20,056,181	24,260,957
Total.....	361,466,770	62,417,919	423,884,689
Collected from assets as above.....	183,654,324	29,550,393	213,204,717
Collected from assessment upon shareholders.....	22,931,541	2,133,226	25,064,767
Total collections.....	206,585,865	31,683,619	238,269,484
Disposition of collections:			
Loans paid and other disbursements.....	42,802,124	6,992,900	49,795,024
Dividends paid.....	144,677,493	20,432,269	165,109,759
Legal expenses.....	5,512,559	631,265	6,144,024
Receiver's salary and other expenses.....	9,769,832	1,163,836	10,933,718
Amount returned to shareholders in cash.....	3,784,833	4,246	3,789,079
Balance with the comptroller or receiver.....	38,874	2,458,006	2,497,880
Total.....	206,585,865	31,683,619	238,269,484
Capital stock at date of failure.....	\$ 92,095,920	6,025,000	98,120,920
United States bonds held at failure to secure circulating notes.....	30,958,550	4,317,550	35,276,100
Amount realized from sale of United States bonds held to secure circulating notes.....	32,716,165	50,500	32,766,665
Circulation outstanding at failure.....	28,704,904	3,700,679	32,405,583
Amount of assessment upon shareholders.....	47,288,240	4,860,000	52,148,240
Claims proved.....	187,313,581	32,618,581	219,930,162

¹Includes 40 banks restored to solvency.

²Includes capital stock of 40 banks restored to solvency.

Enforcing Regulations.

*From the Report of the Comptroller of the Currency for 1921,
pp. 91-92.*

Section 5239 of the Revised Statutes of the United States provides in part that "If the directors of any national banking association shall knowingly violate or knowingly permit any of the officers, agents, or servants of the association to violate any of the provisions of the title [national bank act], all the rights, privileges, and franchises of the association shall be thereby forfeited." Such violation shall, however, be determined and adjudged by . . . a court of the United States, in a suit brought for that purpose by the Comptroller of the Currency in his own name, before the association shall be dissolved.

Examinations of the First National Bank of Hagerstown, Md., made during the past two or three years evidenced the fact that the affairs of the association had not been conducted in conformity with the provisions and limitations of law, and that directions from the Comptroller, addressed to the board of directors, in reference to unlawful transactions, both of commission and of omission, were disregarded.

In these circumstances the Comptroller reached the conclusion that action in the premises as provided by the section cited was demanded. Prior to reaching that conclusion, however, the Comptroller urged that a change in management be effected in order that the conduct of the business of the bank might be conducted by those having due regard to the requirements of law, or, as an alternative, that the bank be placed in voluntary liquidation. Neither of these suggestions received favorable consideration. The matter therefore was brought to the attention of the Department of Justice, and on September 28, 1921, a suit was entered in the United States District Court for the District of Maryland to forfeit the charter of the association.

In anticipation of a run on the bank resulting from the filing of suit and in order to conserve the interests of all creditors the court appointed Robert D. Garrett (national bank examiner) as temporary receiver pending a hearing and answer on the bill of complaint. The receiver was directed to and did file with the clerk of the court a bond in the penal sum of \$50,000, whereupon he was directed to take charge of the bank and of all of its assets, holding them subject to further orders of the court, and to suspend all payments and to collect all maturing notes and obligations of the bank.

Between the date of filing of the suit and the time fixed for the hearing a conference was held by the directors of the bank with the United States District Attorney, and the question was raised as to whether con-

sideration would be given to an application for discontinuance of forfeiture proceedings conditioned upon an entire change in management and disposal of their stock interests by those responsible for the condition of the bank. This proposition received the favorable consideration of the Department of Justice and the Comptroller of the Currency, conditioned upon the resignation of former directors and officers and sale of all shareholdings to those whose means and ability evidenced that in their control the affairs of the bank would be managed in conformity with law.

Subsequent to the conference an agreement was entered into by the old and new interests for the sale of the shares of stock of the bank. Upon the filing of a copy of the agreement with the Comptroller's Office, the United States attorney was advised that it would be agreeable to the Comptroller to have the forfeiture proceedings discontinued, the receiver discharged, and the bank turned over to the new management.

Acting upon this advice, an order of court was issued withdrawing the receiver and permitting the bank to resume business on October 8, 1921.

Limitation on Borrowing.

From the Federal Reserve Bulletin, vol. 8, pp. 933-934 (Aug., 1922).

Analysis of Section 5200 R. S.

In view of this amendment, and for the information of member State banks particularly, the Federal Reserve Board deems it appropriate at this time to republish the analysis of the provisions of section 5200 of the Revised Statutes which was previously published on page 1055 of the *Federal Reserve Bulletin* for November, 1919.

The analysis states the amount which may be loaned to any person, company, firm, or corporation (including in the liability of a company or firm the liability of the several members thereof) under the various clauses of section 5200, as last amended by the act approved October 22, 1919. These amounts are stated in terms of the percentage of the paid-in and unimpaired capital and surplus of the lending bank.

Character of loans.	Amount loanable.
(A) Accommodation or straight loans, whether or not single name.	Maximum limit, 10 per cent of bank's paid-up and unimpaired capital and surplus.
(B) "Bills of exchange drawn in good faith against actually existing values." The law expressly provides that this phrase shall also include: (a) Drafts and bills of exchange secured by shipping documents conveying or securing title to goods shipped. (b) Demand obligations, when secured by documents covering commodities in actual process of shipment. (c) Bankers' acceptances of the kinds described in section 13 of the Federal Reserve Act.	No limit imposed by law.
(C) Commercial or business paper (of other makers) actually owned by the person, company, corporation, or firm negotiating the same.	No limit imposed by law.
(D) Notes secured by shipping documents, warehouse receipts, or other such documents conveying or securing title covering readily marketable non-perishable staples, including live stock. No bank may make any loan under (D), however. (a) Unless the actual market value of the property securing the obligation is not at any time less than 115 per cent of the face amount of the note, and (b) Unless the property is fully covered by insurance, and in no event shall the privilege afforded by (D) be exercised for any one customer for more than 6 months in any consecutive 12 months.	15 per cent of bank's capital and surplus, in addition to the amount allowed under (A); or if the full amount allowed under (A) is not loaned, then the amount which may be loaned in the manner described under (D) is increased by the loanable amount not used under (A). In other words, the amount loaned under (A) must never be more than 10 per cent, but the aggregate of (A) and (D) may equal, but not exceed, 25 per cent.

(E) Notes secured by not less than a like face amount of bonds or notes of the United States issued since April 24, 1917, or by certificates of indebtedness of the United States.	10 per cent of bank's capital and surplus, in addition to the amount allowed under (A); or if the full amount allowed under (A) is not loaned, then the amount which may be loaned in the manner described under (E) is increased, by the loanable amount not used under (A). In other words, the amount loaned under (A) must never be more than 10 per cent, but the aggregate of (A) and (E) may equal, but not exceed, 20 per cent.
(F) Notes secured by United States Government obligations of the kinds described under (E), the face amount of which is at least equal to 105 per cent of the amount of the customer's notes.	No limit, but this privilege, under regulations of the Comptroller of the Currency, expires December 31, 1922.

SOME EXAMPLES OF WHAT MAY BE LOANED TO ANY ONE CUSTOMER,
UNDER SECTION 5200 OF THE REVISED STATUTES, EXPRESSED IN
TERMS OF PERCENTAGE OF THE LENDING BANK'S CAPITAL
AND SURPLUS.

	<i>Per cent.</i>	<i>Per cent.</i>	<i>Per cent.</i>
(A) Accommodation or straight loans	10	5	5
(D) Notes secured by warehouse receipts, etc..	15	20	15
(E) Notes secured by a like face amount of United States Government obligations..	10	10	15
Total	35	35	35
(B) Bills of exchange drawn against actually existing values	No limit imposed by law. Do. Do.		
(C) Commercial or business paper			
(F) Notes secured by at least 105 per cent of United States Government obligations..			

Investments of National Banks.

From the Report of the Comptroller of the Currency for 1921, p. 30.

[In thousands of dollars.]

RESOURCES.

Loans and discounts:

On demand (secured by collateral other than real estate).....	\$1, 493, 508
On demand (not secured by collateral).....	679, 704
On time (secured by collateral other than real estate)....	2, 868, 376
On time (not secured by collateral).....	6, 564, 444
Secured by farm land.....	161, 661
Secured by other real estate.....	118, 576
Not classified (including acceptances and letters of credit).....	356, 533

Total.....¹ \$12, 242, 802

Overdrafts..... \$9, 970

Investments (including bonds):

United States bonds.....	\$2, 019, 497
State, county, and municipal bonds.....	393, 682
Railroad bonds.....	404, 936
Bonds of other public service corporations (including street and interurban railway bonds).....	277, 205
Other bonds, stocks, warrants, etc.....	929, 761

Total..... 4, 025, 081

Banking house (including furniture and fixtures)..... 410, 392

Other real estate owned..... 51, 742

Due from banks..... 1, 344, 519

Lawful reserve with Federal reserve bank or other reserve agents 1, 040, 205

Checks and other cash items..... 121, 716

Exchanges for clearing house..... 656, 093

Cash on hand:

Gold coin.....	\$21, 183
Silver coin.....	² 40, 430
Paper currency.....	³ 312, 736

Total..... 374, 349

Other resources..... 240, 993

Total resources..... 20, 517, 862

LIABILITIES.

Capital stock paid in..... 1, 273, 880

Surplus..... 1, 026, 256

Undivided profits (less expenses and taxes paid)..... 496, 155

National bank circulation..... 704, 147

Due to all banks..... 2, 151, 011

Individual deposits (including postal savings):

Demand deposits—

Individual deposits subject to check.....	\$8, 036, 561
Demand certificates of deposit.....	290, 414
Certified checks and cashiers' checks.....	336, 650
Dividends unpaid.....	32, 281

Time deposits—

Savings deposits, or deposits in interest or savings department.....	2, 957, 555
Time certificates of deposit.....	⁴ 684, 039
Postal savings deposits.....	36, 384
Deposits not classified.....	368, 397

Total..... 12, 742, 281

United States deposits (exclusive of postal savings)..... 249, 039

Notes and bills rediscounted..... 879, 416

Bills payable (including certificates of deposit representing money borrowed)..... 592, 563

Other liabilities..... 403, 114

Total liabilities..... 20, 517, 862

Suggested Readings on Chapter XIII.

- White, Horace.—Money and Banking, Chapter XIV.
Holdsworth, J. T.—Money and Banking, Chapter XI.
Willis, H. P., and Edwards, G. W.—Banking and Business,
Chapters XXIV and XXV.
Sprague, O. M. W.—Crises under the National Banking
System.

Questions and Problems on Chapter XIII.

1. Much is made of the prestige of having a national charter. Is there any rational basis for such a feeling?

2. The Far Rockaway National Bank of New York City has a capital of \$50,000. How can this be?

3. Can a national bank issue notes on the basis of Liberty bonds? Why should a bank be limited in issuing notes to its capital? Under what conditions will new notes be needed? Will conditions in the bond market be favorable or unfavorable for the banks to buy bonds at such a time?

4. Why is the limitation on loans based on the capital and surplus of the bank instead of on the total investments?

5. Why is a bank required to get a surplus?

6. From the standpoint of the stockholders, why is it preferable to have the investment in the form of surplus rather than in the form of capital?

7. What justification is there in the reserve requirement for country banks being lower than that for New York banks?

8. If a man has \$20,000 of Liberty bonds and \$30,000 of bills of exchange, how much could be borrowed from a national bank with a capital and surplus of \$100,000? Of \$200,000? Of \$300,000?

9. In 1921, out of \$727,512,490 of national bank notes outstanding, \$576,522,950 were based on 2 per cent bonds which mature in 1930. What action should be taken in 1930 with reference to these bonds?

10. A promoter starts a national bank in Auburn N. Y., with a capital of \$100,000. You subscribe for \$1,000 in stock. You have paid in \$600. After contracting debts for \$60,000, the promoter leaves for Mexico with all of the cash. How much are you called upon to pay? What is your total loss? How much less is your loss than it might have been?

CHAPTER XIV.

STATE REGULATION OF BANKS—ILLUSTRATED BY NEW YORK.

1. Banking Department.

To the banking department is intrusted the enforcement of the law. It is conducted by a superintendent appointed by the governor. The superintendent grants an authorization certificate to a new bank when it has complied with the law. The bank must have it in order to do business. The capital must be fully paid in cash.

2. Private bankers.

Frequently, private bankers are not regulated. New York wishes to protect the customers of small private bankers but does not wish to interfere with the large private bankers engaged in investment banking.

3. Reports.

Reports must be made four times a year as of dates specified by the superintendent.

4. Branches.

The superintendent may permit a bank to open branch offices. This is a valuable privilege, especially in competition with national banks.

5. Taking possession.

The superintendent may take charge of a bank when it has violated the law or is in an unsound condition or has refused to submit to regulation. In some States, the officer must get an order from a court in order to take possession of a bank.

6. Incorporation.

Five or more incorporators are necessary to start a bank.

7. Capital.

The amount of capital is dependent upon the population :

<i>Population.</i>	<i>Capital required.</i>
Not over 2,000	\$25,000
2,000 to 30,000	50,000
Over 30,000	100,000

8. Length of charter.

The term of existence may be perpetual.

9. Deposit.

To insure obedience to the law, the bank must deposit \$1,000 in New York or United States bonds.

10. Powers.

The bank is permitted to:

- a.* Carry on discount operations.
- b.* Accept deposits.
- c.* Buy and sell exchange, coin, and bullion.
- d.* Lend money on real or personal security.
- e.* Accept drafts.
- f.* Invest in United States bonds or New York State or municipal bonds.
- g.* Hold stock in safe deposit companies and in foreign banking corporations.
- h.* Hold stock in the Federal reserve bank.
- i.* Hold real estate for the conduct of its business or to secure debts.
- j.* Act in a trust capacity, when authorized.

11. Restrictions on loans.

Not more than 10 per cent of capital and surplus may be loaned to one borrower unless on bills of exchange or secured by collateral security. In this case, the total may be 25 or 40 per cent, depending on the location of the bank. The bank must not loan money to finance the purchase of its own stock. Loans to officers, directors, and employees require the written approval of the board of directors.

12. Reserves.

On demand deposits, population is the determining factor:

<i>Population.</i>	<i>Percentage of reserves.</i>
In places with population over two million	18 per cent; at least 12 per cent on hand.
In places with population from one to two million	15 per cent; at least 10 per cent on hand.
Elsewhere	12 per cent; at least 4 per cent on hand.

If a bank is a member of the Federal reserve system, keeping the required reserve in the Federal reserve bank, it is exempt from this provision.

13. Surplus.

A surplus of at least 20 per cent of the capital must be paid in or accumulated from earnings.

14. Stockholders have double liability.

15. Directors.

These must be citizens of the United States, and at least three-quarters of them must be residents of New York State. They must examine the bank twice a year.

16. Foreign banking corporations.

Concerns of this sort cannot do business within the State without a license from the superintendent.

Materials on Chapter XIV.**Selected Sections from the Banking Law of New York.**

§10. *Banking Department; Superintendent; Appointment; Term of Office; Qualifications; Compensation; Oath; Bond.*

There shall continue to be a banking department charged with the execution of the laws relating to the individuals, partnerships, unincorporated associations and corporations to which this chapter is applicable. The chief officer of such department shall continue to be known as the superintendent of banks. He shall have supervision of every such individual, partnership, unincorporated association and corporation, and shall exercise such powers and perform such duties as are conferred and imposed upon him by this chapter or by any law of this State.

The superintendent of banks shall be appointed by the governor, by and with the advice and consent of the senate, and after the termination of the term of office of the incumbent at the time this act takes effect shall hold his office for the term of three years, beginning on the first day of July succeeding his appointment and ending on the first of July in the third calendar year thereafter, provided that the term of office of the superintendent appointed to succeed the superintendent who was in office on the first day of January, nineteen hundred and fourteen, shall continue until the first day of July, nineteen hundred and seventeen, and that a vacancy in such office shall be filled only for the balance of the unexpired term.

The superintendent shall not, either directly or indirectly, be interested in any corporation to which this chapter is applicable, or engage in business as a private banker or personal loan broker. After the termination of the term of office of the incumbent at the time this act takes effect, the superintendent of banks shall receive an annual salary of ten thousand dollars, to be paid monthly. The superintendent shall, within fifteen days from the time of notice of his appointment, take and subscribe the constitution oath of office and file the same in the office of the secretary of state, and execute to the people of the State a bond in the sum of fifty thousand dollars, with two or more sureties to be approved by the comptroller and treasurer of the State, conditioned for the faithful discharge of the duties of his office.

§23. *Investigation by Superintendent of Proposed Corporation, Private Banker or Personal Loan Broker; Refusal or Approval; Filing Certificate.*

When any such certificate shall have been filed for examination, the superintendent shall thereupon ascertain from the best sources of in-

formation at his command, and by such investigation as he may deem necessary, whether the character, responsibility and general fitness of the person or persons named in such certificate are such as to command confidence and warrant belief that the business of the proposed corporation, private banker or personal loan broker will be honestly and efficiently conducted in accordance with the intent and purpose of this chapter, and whether the public convenience and advantage will be promoted by allowing such proposed corporation, private banker or personal loan broker to engage or continue in business. . . .

§24. *Authorization Certificate; When and to Whom Issued; Filing and Recording.*

Before authorizing any corporation, private banker or personal loan broker to begin or continue business the superintendent shall be satisfied that such corporation, banker or broker has in good faith complied with all the requirements of law and fulfilled all the conditions precedent to commencing business imposed by this chapter. In the case of every stock corporation, he shall examine or cause an examination to be made in order to ascertain whether all of its capital stock has been fully paid in cash. In the case of every personal loan broker and of every private banker, subject to all the provisions of article four of this chapter, he shall examine or cause an examination to be made in order to ascertain whether there has been invested in such business, or deposited in cash to be invested therein, the amount of permanent capital stated in the certificate of such banker or broker.

If satisfied that such corporation, banker or broker has in good faith complied with all the requirements of law and fulfilled all the conditions precedent to commencing business imposed by this chapter, the superintendent shall, within six months after the date on which such organization certificate or private banker's or personal loan broker's certificate was filed by him for examination, but in no case after the expiration of that period issue under his hand and official seal, in triplicate, an authorization certificate to the person or persons named in such organization certificate or private banker's or personal loan broker's certificate. Such authorization certificate shall state that the corporation, private banker or personal loan broker named therein has complied with the provisions of this chapter and with all the requirements of law, that it is authorized to transact within this State the business specified therein, and that such business can safely be intrusted to it. One of the triplicate authorization certificates shall be transmitted by the superintendent to the corporation, private banker, or personal loan

broker, thereby authorized to commence or continue business, another shall be filed in the office of the superintendent, and the third shall be filed by the superintendent in the county clerk's office wherein the organization certificate of such corporation or the private banker's or personal loan broker's certificate has been filed by him. The superintendent and said county clerk shall respectively attach such authorization certificate to such organization certificate or private banker's or personal loan broker's certificate previously filed in his office and shall record both such certificates in the book of records of incorporation therein.

§39. *Examinations of Corporations, Bankers, Brokers, and Agencies.*

The superintendent shall either personally or by his deputies or examiners, at least twice in each year, visit and examine every bank, trust company and individual banker, and every private banker subject to the provisions of article four of this chapter, except such as shall have duly obtained certain exemptions pursuant to section one hundred sixty of this chapter; and he shall also in like manner visit and examine at least once in each year every other corporation to which this chapter is applicable, and every personal loan broker. He shall have power in like manner to examine every corporation to which this chapter is applicable, at any time prior to its dissolution, and every such private and individual banker and personal loan broker, whenever, in his judgment, such examination is necessary or expedient. He shall have power in like manner to examine every agency located in this State of any foreign banking corporation for the purpose of ascertaining whether it has violated any law of the State and for such other purposes and as to such other matters as the superintendent may prescribe.

On every such examination inquiry shall be made as to the condition and resources of such corporation, banker or broker, the mode of conducting and managing its affairs, the actions of its directors, or trustees if a corporation, the investment of its funds, the safety and prudence of its management, the security afforded to those by whom its engagements are held, and whether the requirements of its charter and of law have been complied with in the administration of its affairs; and as to such other matters as the superintendent may prescribe.

The superintendent may also make such special investigations as he shall deem necessary to determine whether any individual or corporation has violated any of the provisions of this chapter.

The superintendent and every such examiner shall have power to administer an oath to any person whose testimony may be required on the examination or investigation of any such individual, corporation,

banker, broker or agency, and to compel the appearance of any such person for the purpose of any such examination.

Such examination may be made and such inquiry instituted or continued in the discretion of the superintendent after he has taken possession of the property and business of any such corporation, banker or broker under the provisions of section fifty-seven of this article until it shall resume business or its affairs shall be finally liquidated in accordance with the provisions of this article.

If the examination shall be made by the superintendent, or by one or more deputies or examiners who are compensated by salary only, no charge shall be made except for necessary traveling and other actual expenses.

§42. Reports from Corporations, Bankers and Brokers.

It shall be the duty of the superintendent to require all corporations to which this chapter is applicable, all individual bankers and personal loan brokers and all private bankers to whom article four of this chapter is applicable, to make to him the regular periodical reports of their condition prescribed by this chapter and he shall prescribe the form and contents of all such reports. In addition to such regular reports, he may require any such corporation, banker or broker to make special reports to him at such times and in such form as he may prescribe, and may direct that such special reports be verified and prescribe the form of the verification.

He shall at least once in every three months designate some day therein in respect to which every such bank, trust company and individual banker and every such private banker except such as shall have duly obtained certain exemptions pursuant to section one hundred sixty of this chapter, shall report to him, and he shall serve a notice designating such day. Such notice may be served by delivering the same to such private or individual banker or, in the case of a corporation, by delivering the same at its place of business to some officer therein, or it may be served in any case by depositing it in the post-office inclosed in a postpaid wrapper directed to such corporation or banker at its principal place of business.

§51. Branch Offices; Approval or Refusal; Certificate.

Upon receipt by the superintendent of a written application for leave to open a branch office from a corporation authorized by this chapter to open branch offices, he shall make such investigation as he may deem necessary to ascertain whether the public convenience and advantage will be promoted by the opening of such branch office and whether such corporation has the amount of actually paid-in capital required by this

chapter. If satisfied that the granting of such application is expedient and desirable, he shall make a certificate in triplicate under his hand and official seal authorizing the opening and occupation of such branch office and specifying the date on or after which and the conditions under which it may be opened and the place where it shall be located, and shall file one triplicate in his own office, one in the office of the clerk of the county wherein the principal place of business of such corporation is located, and shall transmit the other to such applicant. If the superintendent shall be satisfied that the opening of such branch office is undesirable or inexpedient or that such corporation has not the requisite amount of capital actually paid in, he shall refuse such application and notify such corporation of his determination.

§57. *When Superintendent May Take Possession of the Delinquent Corporation, Banker or Personal Loan Broker.*

The superintendent may forthwith take possession of the business and property of any corporation to which this chapter is applicable, or any individual banker or personal loan broker, or any private banker to which article four of this chapter is applicable whenever it shall appear that such corporation or banker:

1. Has violated its charter or any law;
2. Is conducting its business in an unauthorized or unsafe manner;
3. Is in an unsound or unsafe condition to transact its business;
4. Cannot with safety and expediency continue business;
5. Has an impairment of its capital;
6. Has suspended payment of its obligations;
7. Has neglected or refused to comply with the terms of a duly issued order of the superintendent;
8. Has refused, upon proper demand, to submit its records and affairs for inspection to an examiner of the banking department;
9. Has refused to be examined upon oath regarding its affairs.

The superintendent may also forthwith take possession of the business and property of any savings and loan association which for two years after due demand or notice of withdrawal has been filed with it by any shareholder, has failed to pay matured shares or withdrawals or any part thereof, as provided in section three hundred ninety-eight of this chapter.

§100. *Incorporation; Organization Certificate; Amount of Capital Stock.*

When authorized by the superintendent of banks, as provided by section twenty-three of this chapter, five or more persons may form a

corporation to be known as a bank. Such persons shall subscribe and acknowledge an organization certificate in duplicate, which shall specifically state:

1. The name by which the bank is to be known:
2. The place where its business is to be transacted.
3. The amount of its capital stock, and the number of shares into which such capital stock shall be divided, which capital stock shall amount to not less than:

(a) Twenty-five thousand dollars, if the place where its business is to be transacted is an incorporated or unincorporated village the population of which does not exceed two thousand;

(b) Fifty thousand dollars, if the place where its business is to be transacted is an incorporated or unincorporated village or a city, the population of which exceeds two thousand but does not exceed thirty thousand;

(c) One hundred thousand dollars, if the place where its business is to be transacted is a city the population of which exceeds thirty thousand.

4. The names and places of residences of the incorporators and the number of shares subscribed for by each.

5. The term of its existence which may be perpetual.

6. The number of directors of the bank, which shall not be less than five nor more than thirty, and the names of the incorporators who shall be its directors until the first annual meeting of the stockholders. The incorporators named as directors must possess the qualifications of directors as to citizenship and residence specified in section one hundred and twenty-three of this article; and the certificate shall recite that such qualifications are possessed by such incorporators.

Such certificate may provide for the manner in which the stock of the corporation may be transferred and for the number of directors necessary to constitute a quorum.

§103. *When Corporate Existence Begins; Conditions Precedent to Commencing Business.*

When the superintendent shall have indorsed his approval on the organization certificate as provided by section twenty-three of this chapter, the corporate existence of the bank shall begin, and it shall then have power to elect officers and transact such other business as relates to its organization. But the bank shall transact no other business until:

1. All of its capital stock shall have been fully paid in cash and an affidavit stating that it has been so paid, subscribed and sworn to by its two principal officers, shall have been filed in the clerk's office of the

county in which its principal office is located, and a certified copy thereof in the office of the superintendent;

2. It shall have made the deposit with the superintendent required by section one hundred five of this article;

3. The superintendent shall have duly issued to it the authorization certificate specified in section twenty-four of this chapter.

§105. Deposit of Securities with Superintendent.

Every bank shall, until an order of the Supreme Court is obtained declaring its business closed, keep on deposit with the superintendent of banks as a pledge of good faith and as a guaranty of compliance with the provisions of this chapter, interest-bearing stocks or bonds of this State or of the United States to the amount of one thousand dollars, which shall be registered in the name of the superintendent of banks of the State of New York in trust for such bank. Every such bank authorized by the superintendent to act in any fiduciary capacity shall be required to deposit additional securities with the superintendent of banks of the kind and in the amount which would be required of a trust company having the same capital and located in a place of the same population under the provisions of section one hundred and eighty-four of this chapter. Such securities shall be registered in the name of the superintendent of banks of the State of New York as trustee for the beneficiaries of private and court trust funds held by such bank and securities so deposited shall be held for the protection of such private and court trusts and subject to sale and transfer, and to the disposal of the proceeds thereof by the superintendent only on the order of a court of competent jurisdiction. The bank, so long as it shall continue solvent and comply with the laws of the State, may be permitted by the superintendent to collect the interest on the securities so deposited and from time to time to exchange such securities for others as provided by section thirty-five of this chapter, and may examine and compare such securities as provided by section thirty-six of this chapter. In case of the involuntary liquidation of any such bank authorized to act in a fiduciary capacity, the proceeds of the sale of such additional securities deposited by it shall be applied in the first instance to the payment pro rata of the claims of the beneficiaries of such private and court trusts.

§106. General Powers.

In addition to the powers conferred by the general and stock corporations law, every bank shall, subject to the restrictions and limitations contained in this article, have the following powers:

1. To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange and other evidences of debt; by receiving deposits; by buying and selling exchange, coin and bullion, and by lending money on real or personal security.

2. To accept for payment at a future date drafts drawn upon it by its customers and to issue letters of credit authorizing the holders thereof to draw drafts upon it or its correspondents at sight or on time not exceeding one year.

3. To purchase and hold any stocks or bonds or interest-bearing obligations of the United States or of the State of New York or of any city, county, town or village of this State, the interest on which is not in arrears.

4. To purchase and hold, for the purpose of becoming a member of a federal reserve bank, so much of the capital stock thereof as will qualify it for membership in such reserve bank pursuant to an act of congress, approved December twenty-three, nineteen hundred and thirteen, entitled the "federal reserve act"; to become a member of such federal reserve bank, and to have and exercise all powers, not in conflict with the laws of this State, which are conferred upon any such member bank by the "federal reserve act." Such member bank and its directors, officers and stockholders shall continue to be subject, however, to all liabilities and duties imposed upon them by any law of this State and to all the provisions of this chapter relating to banks.

5. To purchase and hold the stock of any safe deposit company organized and existing under the laws of the State of New York and doing business on premises owned or leased by the bank; provided that the purchasing and holding of such stock is first duly authorized by resolution of the board of directors of the bank and by the written approval of the superintendent of banks stating the number and amount of the shares which the bank may purchase and hold; to purchase and hold to an amount not in excess of 10 per centum of the capital and surplus of such bank, the capital stock of any investment company qualified to exercise the powers specified in subdivision one-a of section two hundred and ninety-three of the banking law and the capital stock of any foreign banking corporation licensed to do business in this State and the capital stock of any corporation organized under section twenty-five-a of the federal reserve act and having its home office in the State of New York.

6. To purchase, hold and convey real property for the following purposes:

(a) A plot whereon there is or may be erected a building or buildings suitable for the convenient transaction of its business, from portions of which not required for its own use a revenue may be derived.

(b) Such as shall be conveyed to it in satisfaction of debts previously contracted in the course of its business.

(c) Such as it shall purchase at sales under judgments, decrees or mortgages held by it.

7. To receive, upon terms and conditions to be prescribed by the bank, upon deposit for safekeeping, bonds, mortgages, jewelry, plate, stocks, securities and valuable papers of any kind and other personal property, for hire, and to let out receptacles for safe deposit of personal property.

8. When specially authorized by the superintendent of banks to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which trust companies are permitted to act. Banks in such cases shall not be required to give any bond unless the court or officer making the appointment shall require it, in which event such banks shall have power to execute such bond.

No official oath shall be required of any bank acting in any such fiduciary capacity.

§108. Restrictions on Loans, Purchases of Securities and Total Liabilities to Bank of Any One Person.

A bank subject to the provisions of this article

1. Shall not directly or indirectly lend to any individual, partnership, unincorporated association, corporation, or body politic, an amount which, including therein any extension of credit to such individual partnership, unincorporated association, corporation or body politic, by means of letters of credit or by acceptance of drafts for, or the discount of purchase of the notes, bills of exchange or other obligations of, such individual partnership, unincorporated association, corporation or body politic, will exceed one-tenth part of the capital stock and surplus of such bank, with the following exceptions:

(a) The restrictions in this subdivision shall not apply to loans to, or investments in the interest-bearing obligations of, the United States, this State or any city, county, town or village of this State.

(b) If such bank is located in a borough having a population of two millions or over, the total liability to such bank, of any State other than the State of New York, or of any foreign nation, or of a municipal or

railroad corporation, or of a corporation subject to the jurisdiction of a public service commission of this State, may equal but not exceed twenty-five per centum of the capital and surplus of such bank; and the total liabilities to such bank of any individual, partnership, unincorporated association, or of any other corporation or body politic, may equal but not exceed twenty-five per centum of the capital and surplus of such bank, provided such liabilities are upon drafts or bills of exchange drawn in good faith against actually existing values, or upon commercial or business paper actually owned by the person negotiating the same to such bank, and are indorsed by such person without limitation, or provided such liabilities in excess of ten per centum of such capital and surplus, and not in excess of an additional fifteen per centum of such capital and surplus, are secured by collateral having an ascertained market value of at least fifteen per centum more than the amount of the liabilities so secured.

(c) If such bank is located elsewhere in the State, the total liability to such bank of any State other than the State of New York, or of any foreign nation, or of a municipal or railroad corporation, or of a corporation subject to the jurisdiction of a public service commission of this State may equal but not exceed forty per centum of the capital and surplus of such bank; and the total liabilities to such bank of any individual, partnership, unincorporated association, or of any other corporation or body politic, may equal but not exceed forty per centum of the capital and surplus of such bank, provided such liabilities are upon drafts or bills of exchange drawn in good faith against actually existing values, or upon commercial or business paper actually owned by the person negotiating the same to such bank, and are indorsed by such person without limitation, or provided such liabilities in excess of ten per centum of such capital and surplus, and not in excess of an additional thirty per centum of such capital and surplus, are secured by collateral having an ascertained market value of at least fifteen per centum more than the amount of the liabilities so secured.

(d) In computing the total liabilities of any individual to a bank, there shall be included all liabilities to the bank of any partnership or unincorporated association of which he is a member, and any loans made for his benefit or for the benefit of such partnership or association; of any partnership or incorporated association to a bank there shall be included all liabilities of its individual members and all loans made for the benefit of such partnership or unincorporated association or any member thereof; and of any corporation to a bank there shall be included all loans made for the benefit of the corporation.

2. Shall not take or hold at any one time more than ten per centum

of the total capital stock of another moneyed corporation as collateral security for loans.

3. Shall not make any loan upon the securities of one or more corporations the payment of which loan is undertaken in whole or in part severally, but not jointly, by two or more individuals, firms or corporations:

(a) If the prospective borrowers or underwriters be obligated absolutely or contingently to purchase the securities, or any of them, collateral to the proposed loan, unless they shall have paid on account of the purchase of such securities an amount in cash or its equivalent to at least twenty-five per centum of the several amounts for which they remain obligated in completing the purchase;

(b) If the bank considering the making of the loan be liable directly, indirectly or contingently, for the repayment of the proposed loan or any part thereof;

(c) If the term of the proposed loan, including any renewal thereof, by agreement, expressed or implied, exceeds the period of one year;

(d) If the amount, under any circumstances, exceeds twenty-five per centum of the capital and surplus of the bank.

4. Shall not make a loan, directly, or indirectly, upon the security of real estate if

(a) Such real estate is subject to a prior mortgage, lien or incumbrance, and the amount unpaid upon such prior mortgage, lien or incumbrance, or the aggregate amount unpaid upon all prior mortgages, liens and incumbrances exceeds ten per centum of the capital and surplus of such bank, or if the amount so secured, including all prior mortgages, liens and incumbrances, exceeds two-thirds of the appraised value of such real estate as found by a committee of the directors of such bank;

(b) The bank has its principal place of business in a borough of any city in the State which borough has a population of two millions or more, and the total direct and indirect loans by the bank upon the real estate security exceed, or by the making of such loan, will exceed fifteen per centum of the total assets of the bank;

(c) The bank has its principal place of business in a village which has a population of not more than fifteen hundred, and in which there is no savings bank, and the total loans by the bank upon real estate security exceed, or by the making of such loan will exceed forty per centum of its total assets;

(d) The bank has its principal place of business elsewhere in the State, and its total direct and indirect loans upon real estate security exceed, or by making of such loans will exceed, twenty-five per centum of its total assets, provided that if such bank has its principal place of

business in a village or city in which there is no savings bank, and maintains a special interest department for the withdrawal of deposits from which not less than sixty days' notice of withdrawal may be required, it may loan not to exceed fifty per centum of the total deposit of its special interest department in lieu of twenty-five per centum of its total assets, as hereinabove provided, such election on its part, before becoming effective, to be certified to the superintendent of banks by the president and secretary of said bank thereunto duly authorized by its board of directors.

The limitations and restrictions contained in this subdivision shall not prevent the acceptance of any real estate securities to secure the payment of a debt previously contracted in good faith, but every mortgage and every assignment of a mortgage taken or held by such bank shall immediately be recorded in the office of the clerk or the proper recording officer of the county in which the real estate described in the mortgage is located.

5. Shall not, nor shall any of its directors, officers, agents or servants, directly or indirectly, purchase or be interested in the purchase of any promissory note or other evidence of debt issued by it for less than its face value. Every bank or person violating the provisions of this subdivision shall forfeit to the people of the State three times the face value of the note or other evidence of debt so purchased.

6. Shall not make any loan or discount on the security of the shares of its own capital stock, or be the purchaser or holder of any such shares, unless such security or purchase shall be necessary to prevent loss upon a debt previously contracted in good faith, and stock so purchased or acquired shall be sold at public or private sale, or otherwise disposed of, within six months from the time of its purchase or acquisition. Any bank violating any of the provisions of this subdivision shall forfeit to the people of the State twice the amount of the loan or purchase.

7. Shall not knowingly lend, directly or indirectly, any money or property for the purpose of enabling any person to pay for or hold shares of its stock, unless the loan is made upon security having an ascertained or market value of at least fifteen per centum more than the amount of the loan. Any bank violating the provisions of this subdivision shall forfeit to the people of the State twice the amount of the loan.

8. Shall not, nor shall any officer thereof, lend directly or indirectly any sum of money to any officer, director, clerk or employee of the bank without the written approval of a majority of the board of directors thereof, filed in the office of the bank or embodied in a resolution adopted by a majority vote of such board exclusive of the director to whom the

loan is made, or in any event to any officer thereof, if such bank is located in a city of the first class; and if any such officer, director, clerk or employee shall own or control a majority of the stock of any other corporation a loan to that corporation shall be considered for the purpose of this subdivision as a loan to him. Every bank or officer thereof violating this provision shall, for each offense, forfeit to the people of the State twice the amount lent.

9. None of the limitations or restrictions contained in the previous subdivisions of this section shall apply to loans, discounts or other extensions of credit secured by Liberty bonds or by other bonds or securities issued by the United States Government for war purposes, if the market value of such Liberty bonds or other securities exceeds by ten per centum the amount of any such loan, discount or other extension of credit.

§110. Restrictions on Branch Offices; Penalty for Violation.

No bank, or any officer or director thereof, shall transact its usual business of banking at any place other than its principal place of business except that a bank in a city which has a population of more than fifty thousand, may open and occupy in such city one or more branch offices for the receipt and payment of deposits and for making loans and discounts to customers of such respective branch offices only, provided that before any such branch or branches shall be opened or occupied:

1. The superintendent shall have given his written approval, as provided in section fifty-one of this chapter;

2. The actual paid-in capital of such bank shall exceed by the sum of one hundred thousand dollars, the amount required by section one hundred of this article for each branch opened since the twenty-seventh day of April, nineteen hundred and eight; and by the sum of fifty thousand dollars for each branch opened previous to said date and hereafter maintained.

Any bank having a combined capital and surplus of one million dollars or over, may with the written approval of the superintendent open and occupy a branch office or branch offices in one or more places located without the State of New York, either in the United States of America or in foreign countries.

Every bank and every such officer violating the provisions of this section shall forfeit to the people of the State the sum of one thousand dollars for every week during which any branch office shall hereafter be open or occupied in violation of this section.

§112. *Reserves Against Deposits.*

Every bank shall maintain total reserves against its aggregate demand deposits, as follows:

1. Eighteen per centum of such deposits if such bank has an office in a borough having a population of two millions or over; and at least twelve per centum of such deposits shall be maintained as reserves on hand, except as otherwise provided in this section.

2. Fifteen per centum of such deposits, if such bank is located in a borough having a population of one million or over and less than two millions, and has not an office in a borough specified in subdivision one of this section; and at least ten per centum of such deposits shall be maintained as reserves on hand.

3. Twelve per centum of such deposits if such bank is located elsewhere in the State; and at least four per centum of such deposits shall be maintained as reserves on hand.

Any part of the reserves on hand in excess of four per centum of such deposits may be deposited, subject to call, with a federal reserve bank in the district in which such bank is located, and the reserves on hand not so deposited shall consist of gold, gold bullion, gold coin, United States gold certificates, United States notes or any form of currency authorized by the laws of the United States; but if any bank shall have become a member of a federal reserve bank, it shall maintain such reserves with such federal reserve banks as are required by the federal reserve act and so long as it complies with the requirements of such federal reserve act with reference to reserves shall be exempt from the preceding provisions of this section.

If any bank shall fail to maintain its total reserves in the manner authorized by this section, it shall be liable to, and shall pay the assessment or assessments provided for in section thirty of this chapter.

§115. *Interest on Collateral Demand Loans of Not Less Than Five Thousand Dollars.*

Upon advances of money repayable on demand to an amount not less than five thousand dollars made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments, pledged as collateral security for such repayment, any bank may receive or contract to receive and collect as compensation for making such advances any sum which may be agreed upon by the parties to such transaction.

§117. Surplus Fund; of What Composed, and For What Purposes Used.

Every bank shall create a fund to be known as a surplus fund. Such fund may be created or increased by contributions, by transfers from undivided profits, or from net earnings. Such fund up to twenty per centum of the capital of the bank shall be used only for the payment of losses in excess of undivided profits.

§118. How Net Earnings Credited for Dividend Purposes; Credits to Surplus Fund and to Undivided Profits; Dividends to Stockholders.

When the net earnings of a bank have been determined at the close of a dividend period as provided in section one hundred sixteen of this article, if its surplus fund does not equal twenty per centum of the bank's capital, one-tenth of such net earnings shall be credited to the surplus fund or so much thereof, less than one-tenth, as will make such fund equal twenty per centum of such capital. The balance of such net earnings, or the entire amount thereof if such fund equals such twenty per centum, may be credited to the bank's profit and loss account; or, if its expenses and losses for such dividend period exceed its gross earnings, such excess shall be charged to its profit and loss account. The credit balance of such account shall constitute the undivided profits at the close of such dividend period, and shall be available for dividends.

The directors of any bank may annually, semiannually or quarterly, but not more frequently, declare such dividends as they shall judge expedient from such undivided profits. No bank shall declare, credit or pay any dividend to its stockholders until it shall have made good any existing impairment of its capital and any existing encroachment on its reserves required to be maintained against deposits.

§120. Rights and Liabilities of Stockholders; Who Liable as Stockholders; Who May Enforce Liability; Within What Time Action Must Be Commenced.

The rights, powers and duties of stockholders of banks shall be as prescribed in the general corporation law and the stock corporation law; but the individual liability of such stockholders for the contracts, debts, and engagements of the bank and the time within which an action may be instituted to enforce such liability shall be governed exclusively by the provisions of this section and section eighty of this chapter.

The stockholders of every bank shall be individually responsible,

equally and ratably and not one for another, for all contracts, debts and engagements of the bank, to the extent of the amount of their stock therein, at the par value thereof, in addition to the amount invested in such shares. An action to enforce such liability must be brought within six years after the cause of action has accrued. . . .

§123. *Qualifications and Disqualifications of Directors.*

Each director must be a citizen of the United States, and at least three-fourths of the directors must be residents of this State at the time of their election and during their continuance in office. If at a time when not more than three-fourths of the directors are residents of this State, any director shall cease to be a resident of this State, he shall forthwith cease to be a director of the bank and his office shall be vacant. Every director of a bank having a capital of fifty thousand dollars or over shall be a stockholder of the bank owning in his own right an amount equal to at least one thousand dollars in value, and of a bank having a capital of less than fifty thousand dollars, a stockholder in his own right in an amount equal to at least five hundred dollars in value; and every person elected to be a director who, after such election, shall hypothecate, pledge or cease to be the owner in his own right of the amount of stock aforesaid, shall cease to be a director of the bank and his office shall be vacant, and he shall not be eligible for re-election as a director for a period of one year from the date of the next succeeding annual meeting.

§130. *Examinations by Directors Into Affairs of Banks; May Employ Assistants.*

It shall be the duty of the Board of Directors of every bank during the months of March or April and during the months of September or October in each year to examine, or to cause a committee of at least three of its members to examine fully the books, papers and affairs of the bank, and the loans and discounts thereof, and particularly the loans or discounts made directly or indirectly to its officers or directors, or for the benefit of such officers or directors, or for the benefit of other corporations of which such officers or directors are also officers or directors, or in which they have a beneficial interest as stockholders, creditors or otherwise, with the special view of ascertaining their safety and present value, and the value of the collateral security, if any, held in connection therewith, and into such other matters as the superintendent of banks may require. Such directors shall have the power to employ such assistance in making such examination as they may deem necessary.

When a bank is a member of the federal reserve system of the United States and of the New York Clearing House Association, thereby becoming subject to at least one examination each year by the federal reserve board and by the New York Clearing House respectively, then and on account of such liability to such examination, the board of directors of such bank may omit the latter of the two examinations provided for in each year by this section.

§133. *Reports to Superintendent; Penalty for Failure to Make.*

Within ten days after service upon it of the notice provided for by section forty-two of this chapter, every bank shall make a written report to the superintendent, which report shall be in the form and shall contain the matters prescribed by the superintendent and shall specifically state the items of capital, deposits, specie and cash items, public securities and private securities, real estate and real estate securities, and such other items as may be necessary to inform the public as to the financial condition and solvency of the bank, or which the superintendent may deem proper to include therein, and shall also state the amount of deposits the payment of which, in case of insolvency, is preferred by law or otherwise over other deposits. Every such report shall be verified by the oaths of the president or vice-president and cashier, or assistant cashier, and such verification shall state that the report is true and correct in all respects to the best of the knowledge and belief of the persons verifying it, and that the usual business of the bank has been transacted at the location required by this article and not elsewhere. Every such report exclusive of the verification shall within thirty days after it shall have been filed with the superintendent, be published by the bank in one newspaper of the place where its principal place of business is located, or if no newspaper is published there, in the newspaper published nearest to such place.

Every such bank shall also make such other special reports to the superintendent as he may from time to time require, in such form and at such date as may be prescribed by him and such report shall, if required by him, be verified in such manner as he may prescribe.

Every such bank which does not have an unimpaired surplus fund equal to at least twenty per centum of its capital shall, within ten days after declaring a dividend, make a written report to the superintendent stating the amount of such dividend, the amount of its net earnings in excess thereof and the amount carried to the surplus fund. Such report shall be verified by the oath of the president or vice-president and cashier, or assistant cashier of the bank.

If any such bank shall fail to make any report required by this section on or before the day designated for the making thereof, or shall fail to

include therein any matter required by the superintendent, such bank shall forfeit to the people of the State the sum of one hundred dollars for every day that such report shall be delayed or withheld, and for every day that it shall fail to report any such omitted matter, unless the time therefor shall have been extended by the superintendent as provided by section forty-nine of this chapter. The moneys forfeited by this section, when recovered shall be paid into the State treasury to reimburse the State for the sums advanced by it for the expenses of the department.

§139. Restrictions on Officers, Directors, and Employees.

No officer, director, clerk or other employee of any bank, and no person in any way interested or concerned in the management of its affairs, shall as individuals discount, or directly or indirectly, make any loan upon any note or other evidence of debt, which he shall know to have been offered for discount to such corporation, and to have been refused. Every person violating the provisions of this subdivision, shall, for each offense, forfeit to the people of the State twice the amount of the loan which he shall have made.

No officer, director, clerk or other employee of any bank shall borrow, directly or indirectly, from the bank with which he is connected any sum of money without the written approval of a majority of the board of directors thereof filed in the office of the bank or embodied in a resolution adopted by a majority vote of such board exclusive of the director to whom the loan is made; and in no event shall any officer of a bank located in a city of the first class borrow any sum of money from such bank. If an officer, director, clerk or other employee of any bank shall own or control a majority of the stock of any other corporation a loan to that corporation shall be considered for the purpose of this subdivision as a loan to such officer, director, clerk or other employee. None of the limitations or restrictions contained in this subdivision shall apply to loans, discounts or other extensions of credit secured by liberty bonds or by other bonds or securities issued by the United States Government for war purposes, if the market value of such liberty bonds or other securities exceed by ten per centum the amount of any such loan, discount or other extension of credit. Every person knowingly violating any provision of this subdivision shall, for each offense, forfeit to the people of the State twice the amount which he shall have borrowed.

§145. When Foreign Banking Corporation May Transact Business in This State.

No foreign banking corporation, other than a bank organized under the laws of the United States, shall transact in this State the business

of buying, selling or collecting bills of exchange, or of issuing letters of credit or of receiving moneys for transmission or transmitting the same by draft, check, cable or otherwise, or of making sterling or other loans or transacting any part of such business, or maintaining in this State any agency for carrying on such business, or any part thereof, unless such corporation shall have:

1. Been authorized by its charter to carry on such business and shall have complied with the laws of the State or country under which it is incorporated;

2. Furnish to the superintendent such proof as to the nature and character of its business and as to its financial condition as he may require;

3. Designated the superintendent of banks by a duly executed instrument in writing, its true and lawful attorney, upon whom all process in any action or proceeding by any resident of the State against it may be served with the same effect as if it were a domestic corporation and had been lawfully served with process within the State;

4. Paid to the superintendent of banks a license fee of two hundred and fifty dollars;

5. Received a license duly issued to it by the superintendent as provided in section twenty-seven of this chapter.

This section shall not be construed to prohibit foreign banking corporations which do not maintain an office in this State for the transaction of business from making loans in this State secured by mortgages on real property, nor from accepting assignments of mortgages covering real property situated in this State, nor from making loans through correspondents which are engaged in the business of banking in this State under the laws of the State.

§150. *Scope of Article.*

The provisions of this article, except as hereinafter further limited, shall apply to every private banker engaged in the business of private banking in any city of the State,

1. Who makes use of any office sign bearing thereon the word "bank", "banker", "banking", or any derivative or compound of the word "bank", or any words in a foreign language having the same or similar meanings, or who makes use of any exterior sign bearing thereon any such word or words or any words whatever to indicate to the general public that such person is engaged in the business of a private banker; or

2. Who pays or credits interest, or pays, credits or gives any bonus or gratuity or anything of value, except on certificates of deposit actually outstanding at the time this act takes effect, to any depositor on a

deposit balance of (a) less than five hundred dollars, if such private banker is engaged in business in a city of the first class, or (b) less than three hundred dollars, if such private banker is engaged in business in a city of the second class, or (c) less than two hundred dollars, if such private banker is engaged in business in a city of the third class; or

3. Who receives money on deposit for safekeeping or for transmission to others or for any other purpose in such sums that the average of the separate deposits so received by such private banker since April first, nineteen hundred fourteen, or during any twelve successive months, or for such period, if less than twelve months, that such private banker has engaged in such business, exclusive of dividend checks, coupons or other small collection items collected by such private banker for customers in the ordinary course of business, is (a) less than five hundred dollars, if such private banker is engaged in such business in a city of the first class having a population of over one million, or (b) less than three hundred dollars, if engaged in business, in any other city of the first class, or (c) less than two hundred dollars if engaged in business in any city of the second class, or (d) less than one hundred dollars, if engaged in such business in any city of the third class.

§160. Conditions Entitling Private Banker to Certain Exemptions, and Extent of Such Exemptions.

Any such private banker who has claimed the right in his verified certificate to engage in business under the provisions of this section, and any such private banker authorized by the superintendent to engage in such business, may submit to the superintendent an affidavit executed in duplicate and verified in the same manner as such certificate, upon a form to be furnished by the superintendent containing a statement as follows:

1. If such private banker is engaged in business as a private banker in a city of the third class, that such private banker has permanently invested in this State in his banking business immediately preceding the date of such affidavit a capital of at least twenty-five thousand dollars over and above all his liabilities as such private banker; or

2. If such private banker is engaged in business as a private banker in a city of the second class, that such private banker has permanently invested in this State in his banking business immediately preceding the date of such affidavit a capital of fifty thousand dollars over and above all his liabilities as such private banker; or

3. If such private banker is engaged in business as a private banker in a city of the first class:

(a) That such private banker has permanently invested in this State

in his banking business a capital of at least one hundred thousand dollars over and above all his liabilities as such private banker, if such banker is engaged in business in such a city with a population of over one million; and at least seventy-five thousand dollars over and above all such liabilities, if such banker is engaged in business in any other such city.

(*b*) That such applicant will not pay or credit or advertise to pay or credit any interest or pay, credit or give any bonus or gratuity whatever or anything of value to any depositor on a deposit balance with such private banker of less than five hundred dollars, if such applicant is engaged in business in such a city with a population of over one million, or less than three hundred dollars, if engaged in business in any other such city.

(*c*) That the average of the separate deposits received by such private banker, since April first, nineteen hundred and fourteen, or during the twelve months immediately preceding the date of such affidavit, for safe-keeping, for transmission, or for any other purpose, exclusive of dividend checks, coupons or other small collection items collected by such private banker for customers in the ordinary course of business is three hundred dollars or more, if such applicant is engaged in business in such a city with a population of over a million or two hundred dollars or more if engaged in business in any other such city.

Provided, however, that subdivisions *b* and *c* of this section shall not apply to certificates of deposit actually outstanding at the time this act takes effect.

After the date upon which the superintendent has accepted and filed in his office such affidavit of any private banker, and until the first day of January next succeeding the subsequent sections of this article shall not apply to such private banker, but such banker shall be subject to the provisions of the sections of article two of this chapter applicable to such private bankers.

Every private banker who has submitted an affidavit which has been duly accepted and filed by the superintendent, and who seeks to continue or to engage in business as a private banker under the provisions of this section after the first day of January succeeding such filing by the superintendent, shall submit to the superintendent during the month of November preceding such first day of January and annually thereafter during the same month an affidavit containing a statement as above specified, verified as of a date within such month. In the event of the failure of such private banker so to do, or of the refusal of the superintendent to accept and file said affidavit, such private banker shall cease to transact business as a private banker until the superin-

tendent shall have issued to him and filed in his office an authorization certificate as required by this article.

§166. Reserves Against Deposits.

Every such private banker shall maintain total reserves against his aggregate demand deposits, as follows:

1. Fifteen per centum of such deposits if such private banker is engaged in business as a private banker in a city of the first class.

2. Ten per centum of such deposits if such private banker is engaged in business as a private banker in any other city.

At least one-tenth of such total reserves shall consist of reserves on hand and the remainder thereof shall consist of reserves on deposit subject to call in any State bank, national banking association or trust company.

If any such private banker shall fail to maintain his total reserves in the manner required by this section, he shall be liable for, and shall pay, the assessment or assessments provided for in section thirty of this chapter.

**Summary of Reports of Accounts of 18,875 State Banks in the
United States and Island Possessions at the Close of
Business June 30, 1921.**

*From the Report of the Comptroller of the Currency for 1921,
pp. 138-139.*

Resources.

Loans and discounts:

On demand (secured by collateral other than real estate)	\$778,990,000
On demand (not secured by collateral)	79,304,000
On time (secured by collateral other than real estate)	746,904,000
On time (not secured by collateral)	643,277,000
Secured by farm land	407,050,000
Secured by other real estate	1,077,829,000
Not classified	5,337,604,000

Total \$9,070,958,000

Overdrafts 68,243,000

Investments (including premiums on bonds):

United States Government securities	\$454,023,000
State, county, and municipal bonds	189,206,000
Railroad bonds	82,325,000
Bonds of other public service corporations (including street and interurban railway bonds)	103,096,000
Other bonds, stocks, warrants, etc.	1,609,407,000

Total 2,438,057,000

Banking house (including furniture and fixtures)	330,005,000
Other real estate owned	55,344,000
Due from banks	845,153,000
Lawful reserve with Federal reserve bank or other reserve agents.	548,630,000
Checks and other cash items	69,094,000
Exchanges for clearing house	209,199,000
Cash on hand:	
Gold coin	\$22,683,000
Silver coin	12,580,000
Paper currency	158,594,000
Nickels and cents	2,462,000
Cash not classified	150,270,000
Total	346,589,000
Other resources	217,827,000
Total resources	14,199,099,000

Liabilities.

Capital stock paid in	1,063,045,000
Surplus	579,830,000
Undivided profits (less expenses and taxes paid)	211,882,000
Due to all banks	337,373,000
Individual deposits (including postal savings):	
Demand deposits—	
Individual deposits subject to check	\$4,196,294,000
Demand certificates of deposit	262,985,000
Certified checks and cashiers' checks	134,321,000
Dividends unpaid	11,070,000
Time deposits—	
Savings deposits or deposits in interest or savings department	2,987,220,000
Time certificates of deposit	1,132,836,000
Postal Savings deposits	8,026,000
Deposits not classified	2,077,036,000
Total	10,809,788,000
United States deposits (exclusive of postal savings)	40,019,000
Notes and bills rediscounted	257,450,000
Bills payable (including certificates of deposit representing money borrowed)	560,839,000
Other liabilities	338,873,000
Total liabilities	14,199,099,000

Summary of Reports of Condition of 708 Private Banks in the United States at the Close of Business, June 30, 1921.

*From the Report of the Comptroller of the Currency for 1921,
pp. 149-150.*

RESOURCES.

Loans and discounts:

On demand (secured by collateral other than real estate).....	\$3,594,000
On demand (not secured by collateral).....	1,842,000
On time (secured by collateral other than real estate)...	8,924,000
On time (not secured by collateral).....	17,043,000
Secured by farm land.....	4,855,000
Secured by other real estate.....	11,404,000
Not classified.....	56,623,000

Total..... \$104,285,000

Overdrafts..... 727,000

Investments (including premiums on bonds):

United States Government securities.....	\$10,774,000
State, county, and municipal bonds.....	3,219,000
Railroad bonds.....	1,658,000
Bonds of other public service corporations (including street and interurban railway bonds).....	1,058,000
Other bonds, stocks, warrants, etc.....	12,652,000

Total..... 29,361,000

Banking house (including furniture and fixtures)..... \$3,846,000

Other real estate owned..... 7,174,000

Due from banks..... 16,878,000

Lawful reserve with Federal reserve bank or other reserve agents..... 4,719,000

Checks and other cash items..... 576,000

Exchanges for clearing house..... 134,000

Cash on hand:

Gold coin.....	\$324,000
Silver coin.....	336,000
Paper currency.....	2,411,000
Nickels and cents.....	60,000
Cash not classified.....	1,339,000

Total..... 4,470,000

Other resources..... 3,136,000

Total resources..... 175,306,000

LIABILITIES.

Capital stock paid in..... 11,601,000

Surplus..... 12,369,000

Undivided profits (less expenses and taxes paid).... 1,956,000

Due to all banks..... 1,342,000

Individual deposits (including postal savings):

Demand deposits—

Individual deposits subject to check.....	\$53,998,000
Demand certificates of deposit.....	17,902,000
Certified checks and cashiers' checks.....	208,000
Dividends unpaid.....	24,000

Time deposits—

Savings deposits, or deposits in interest or savings department.....	25,082,000
Time certificates of deposit.....	21,451,000
Postal savings deposits.....	2,000
Deposits not classified.....	15,230,000

Total..... 133,897,000

United States deposits (exclusive of postal savings)..... 109,000

Notes and bills rediscounted..... 1,863,000

Bills payable (including certificates of deposit representing money borrowed)..... 7,828,000

Other liabilities..... 4,341,000

Total liabilities..... 175,306,000

Suggested Readings on Chapter XIV.

Dewey, D. R.—State Banking before the Civil War.

Barnett, G. E.—State Banks and Trust Companies since the
Passage of the National Bank Act.

Questions and Problems on Chapter XIV.

1. Is it better to have the supervision of the bank in the hands of one man or in the hands of a commission of three or five?

2. Which method would probably get the best superintendent:

- a. Election by State bankers' association?
- b. Election by people of the whole State?
- c. Selection by the legislature?
- d. Selection by the governor?

3. How can the superintendent be sure that the report made to him is accurate?

4. Which is better in the case of a delinquent bank, from the standpoint of the banks and the public: court action or independent action by the superintendent?

5. Can you conceive of a violation of the law which a bank could afford to make even if it knew it would forfeit its \$1,000 deposit?

6. The restriction of loans to 10 per cent of capital and surplus is equivalent to what per cent of the total investments of the bank?

7. Could a bank in Utica with a capital and surplus of \$100,000:

- a. Loan \$15,000 to one firm on a promissory note?
- b. Loan \$30,000 by discounting notes of a firm's customers?
- c. Buy \$50,000 of Illinois bonds?
- d. Loan \$10,000 on a straight note and \$30,000 on a note secured by 40 shares of stock quoted at 86 per share?

8. Could a bank in Brooklyn with assets of \$1,500,000 have \$250,000 in real estate loans?

9. A house worth \$10,000 has a first mortgage of \$6,500 and a second mortgage of \$2,000. Could a bank hold the first mortgage? The second mortgage?

10. What dangers are involved in loans to directors, officers and employees?

11. Could the Corn Exchange Bank of New York establish a branch in Albany? In Buffalo? In Cleveland? In Chicago?

12. A bank in the Bronx has \$1,000,000 in demand de-

posits. What is the smallest amount of reserve in its own vaults it might keep and obey the law.

13. A bank with \$100,000 capital and a surplus of \$16,000 makes \$48,000 earnings. Can it declare a dividend of 20 per cent? 30 per cent? 35 per cent? 40 per cent? 45 per cent? 48 per cent?

14. How much must a bank with \$150,000 capital appropriate to surplus if its earnings are \$20,000?

15. I own \$1,000 out of \$100,000 of stock in a New York bank. The bank fails and, after all of its assets have been realized upon, owes \$30,000. One-half of the stock is held by bankrupts. How much can I be forced to contribute?

16. What is the objection to more than one-fourth of the directors of a New York bank living in New Jersey suburban towns?

17. Why are directors required to own more than one share of stock?

18. Five men, *A*, *B*, *C*, *D*, and *E*, in Auburn, New York, propose to start a bank. If you were the superintendent of banking, what would you wish to know about the men and about Auburn before you would grant permission to start business?

19. Why is it necessary to have the capital fully paid in cash?

20. Why should banks be examined while coal companies and farmers are not?

21. Why is the date of the bank reports uncertain? Why not specify the four dates in the law?

22. Would "public convenience and advantage" be promoted by having at least one bank office in every block on Broadway from the Battery to Dyckman Street?

23. Is the bank necessarily insolvent when the superintendent takes possession of it?

24. Could the superintendent take possession of a bank because it loaned on Cuban sugar in 1920?

25. What is the minimum capitalization allowable for a bank in New York City? Nyack? Troy?

✓ CHAPTER XV. EUROPEAN BANKING.

General Differences Between Banking in European Countries and in the United States.

1. They have central banks; we have the federal reserve system.
2. They have a few big banks which cover the whole country with many branches; we have a vast number of independent local banks, most of them rather small.
3. With the exception of England, they use checks less than we do.
4. Their commercial banks engage more in investment banking than ours do.
5. They use the bill of exchange more; we use the promissory note more. They lend more on the transaction; we lend more on the general credit of the borrower.
6. Foreign business makes up a greater part of their business than of ours.
7. They have current accounts in which the customer borrows by overdrawing; our practice is to discourage overdrafts and have a definite instrument for each loan.

The English Banking System.

The Bank of England is the central bank. It has branches. The note issues are secured by £18,450,000 of Government debt and, above that, pound for pound of gold. In time of emergency, elasticity is obtained by allowing the bank to issue more notes secured by Government debt. The Chancellor of the Exchequer may give such permission.

The bank is privately owned and privately controlled, except in emergencies when the Government exercises considerable control.

There was no inflation of Bank of England notes as a result of the war. Instead, currency notes were issued by the Government. Over £350,000,000 were put out. The reserve against these notes has been as low as 8.8 per cent.

The commercial banking is in the hands of five big banks, usually called the joint-stock banks, which attained their size mostly through amalgamation. These banks have numerous branches in Great Britain and branches or connections throughout the world.

There are also private bankers who do an investment business and another group of private firms that accept bills of exchange.

The open market for bills of exchange is highly developed. The bills arise in connection with the vast foreign trade which is financed in London. The banks and firms which have the acceptances sell them through note brokers. Because of the great volume of business, it has become highly specialized. The brokers are in a position to sell to the bank the denominations and the maturities of paper they desire.

The German Banking System.

The Reichsbank is the central bank. It is privately owned but practically run by the Government, which shares in the profits.

The notes before the war were secured by gold and commercial paper. Provisions were made for meeting seasonal and panic demands for more notes. The Reichsbank covers Germany with branches and conducts a system of transfers of money which takes the place of our domestic exchange.

The war brought great inflation. Part of the plan for financing the war involved the creation of loan bureaus which loaned on various types of securities, especially to subscribers to the Government bond issues. The loan bureaus issued notes to the borrowers. A new law permitted the Reichsbank to count the notes issued by the loan bureaus as cash reserves against its own notes.

The banking operation involved in inflation is simple. The Government borrows from the Reichsbank and gets the proceeds of the loan in notes of the Reichsbank. Or the Government sells Treasury notes. These are taken by the banks. By law, the Reichsbank must discount them; consequently, if there is any stringency of credit, the other banks discount them at the Reichsbank, which must issue more of its notes to meet the demand.

The commercial business is largely in the hands of a few big banks with many branches. These big banks also engage in investment banking. They place representatives on the boards of directors of the concerns they have financed.

The French Banking System.

The Bank of France is the central bank. It is privately owned. The chief executive officers of the bank are appointed by the President of the Republic. The notes of the bank have only the general assets of the bank back of them. The only limitation has been on the total amount. The maximum allowed is always increased before it hampers the bank. The Bank of France has numerous branches. A group of big banks carry on both a commercial and investment banking business. They also have many branches.

The war brought a great inflation in France. The Bank of France made large advances to the Government in the form of its own notes. After the war, further inflation arose from the expenditure of the Government for reconstruction.

Advantages of Branch Banking.

1. The banks have adequate capital and can take care of large borrowers.
2. Unified policy is possible in emergencies.
3. Uniform interest rates throughout the country are possible.
4. Sound policies can be laid down and enforced by central offices. These offices can have information about business conditions of the whole country.
5. Branches can be established in places too small for local banks.
6. The risks of investment are distributed.
7. Frequent changes in personnel and frequent inspections lessen fraud.

Disadvantages of Branch Banking.

1. It tends to routine, impersonal management.
2. The manager from the outside does not know local conditions.
3. It takes capital away from certain localities.
4. It causes delay in granting loans, due to necessity of referring to the main bank.
5. It drives out small independent banks.

Materials on Chapter XV.

Condition of Principal European Banks of Issue, 1913-1921.

From the Federal Reserve Bulletin, vol. 8, p. 254, 255 (Feb., 1922).

BANK OF ENGLAND.

[Combined data for issue and banking departments.]

[From the London Economist and weekly statements of the Bank of England.]

[In thousands of pounds.]

	Dec. 31, 1913.	Dec. 30, 1914.	Dec. 29, 1915.	Dec. 27, 1916.	Dec. 26, 1917.	Dec. 25, 1918.	Dec. 31, 1919.	Dec. 29, 1920.	Dec. 28, 1921.
ASSETS.									
Gold and silver.....	34,983	69,493	51,476	54,305	53,337	79,111	91,342	128,268	128,434
Government securities:									
Held by issue department.....	18,450	18,450	18,450	18,450	18,450	18,450	18,450	18,450	18,450
Held by banking department.....	13,199	14,808	32,640	57,188	58,303	71,106	92,469	107,865	36,982
Other securities.....	52,138	106,236	112,076	106,461	94,889	92,140	106,778	86,028	83,165
Total.....	118,770	208,987	214,642	236,404	229,979	260,807	309,039	340,611	267,011
LIABILITIES.									
Proprietors' capital.....	14,533	14,533	14,533	14,533	14,533	14,533	14,533	14,533	14,533
Reserve (surplus).....	3,252	3,283	3,312	3,311	3,301	3,257	3,272	3,340	3,334
Public deposits.....	10,296	26,933	49,677	52,116	42,009	23,643	19,213	14,305	16,057
Other deposits.....	61,087	128,055	111,973	126,727	124,162	149,037	180,638	175,554	106,532
Seven-day and other bills.....	14	24	18	22	10	10	13	8	15
Notes in circulation.....	29,608	36,139	35,309	39,675	45,944	70,307	91,350	132,851	126,520
Total.....	118,770	208,987	214,642	236,404	229,979	260,807	309,039	340,611	267,011
Ratio of metallic reserve to deposit and note liabilities combined—per cent.....	34.65	36.36	26.14	24.85	27.50	32.56	31.37	39.75	51.56

BANK OF FRANCE.

[From weekly statements of the Bank of France.]

[In thousands of francs.]

	Dec. 26, 1913.	Dec. 10, ¹ 1914.	Dec. 30, 1915.	Dec. 25, 1916.	Dec. 27, 1917.	Dec. 26, 1918.	Dec. 25, 1919.	Dec. 30, 1920.	Dec. 29, 1921.
ASSETS.									
Gold in vault.....	3,517,322	4,141,757	5,015,287	3,322,237	3,514,417	3,440,460	3,600,245	3,551,022	3,575,831
Other metallic reserve.....	640,663	353,194	352,688	2,281,839	241,557	315,348	235,035	265,333	273,765
Total metallic vault reserve.....	4,157,985	4,494,951	5,367,975	5,604,076	3,755,974	3,755,808	3,835,280	3,816,355	3,849,596
Gold held abroad.....	.....	.....	1,693,083	2,037,108	1,978,278	2,037,108	1,978,278	1,948,367	1,948,367
Foreign credits.....	.....	.....	1,056,799	825,801	778,397	2,336,472	1,296,016	677,976	623,733
-Government securities:	.....	.....	.....	.....	.....	.....	.....	.....	.....
Advances to Government	300,000	300,000	300,000	300,000	300,000	300,000	300,000	300,000	300,000
Advances to banks.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Treasury bills discounted (ad-	.....	.....	.....	.....	.....	.....	.....	.....	.....
vances to foreign Govern-	.....	.....	.....	.....	.....	.....	.....	.....	.....
ments).....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Other Government securities.	.....	.....	.....	.....	.....	.....	.....	.....	.....
Loans and discounts.....	117,958	113,378	112,652	112,979	112,979	112,729	112,913	114,819	114,839
Bills matured and extended.....	1,526,462	213,291	423,321	619,684	915,257	1,052,336	1,285,361	3,311,324	2,506,977
Advances on bullion, specie, se-	.....	.....	.....	.....	.....	.....	.....	.....	.....
curities.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Bank premises.....	772,403	780,753	1,151,916	1,317,753	1,224,798	1,215,715	1,464,331	2,201,705	2,240,918
Sundry assets.....	44,230	.....	50,272	46,086	47,285	46,425	47,281	46,635	54,460
.....	320,005	.....	363,233	502,718	627,520	1,550,272	1,927,158	1,579,028	2,117,353
Total.....	7,238,513	.....	16,296,500	19,634,311	26,465,260	34,114,433	42,162,636	44,982,132	42,561,543
LIABILITIES.									
Capital.....	182,500	182,500	182,500	182,500	182,500	182,500	182,500	182,500	182,500
Surplus (including special re-	.....	.....	.....	.....	.....	.....	.....	.....	.....
serves).....	42,519	.....	42,964	42,964	42,964	42,964	42,972	54,917	72,613
Amortization account (laws 1914,	.....	.....	.....	.....	.....	.....	.....	.....	.....
1917, 1918).....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Dividend paid.....	1,601	.....	21,818	25,147	25,331	427,415	702,934	1,041,628	1,899,022
Government deposits.....	403,359	176,557	173,896	173,896	251,569	111,064	70,497	58,575	15,043
Other deposits.....	579,255	2,671,951	2,123,814	2,294,892	2,917,569	2,385,616	3,129,393	3,519,461	26,014
Bank notes in circulation.....	.....	.....	13,308,850	16,678,818	22,338,799	30,249,612	37,274,540	37,901,599	36,487,457
Sundry liabilities.....	.....	.....	441,658	424,981	710,752	716,602	748,903	2,196,501	1,229,886
Total.....	7,238,513	.....	16,296,500	19,634,311	26,465,260	34,114,433	42,162,636	44,982,132	42,561,543
Ratio of metallic reserve to de-	.....	.....	.....	.....	.....	.....	.....	.....	.....
posits and non-liabilities com-	.....	.....	.....	.....	.....	.....	.....	.....	.....
bined—per cent.....	62.09	35.00	34.39	19.40	13.97	11.48	9.56	9.21	9.83

¹ No data available as at end of 1914. Incomplete data for December 10 taken from report of Minister of Finance.² Advances on securities only.

GERMAN REICHSBANK.

[From annual reports and weekly statements of the Reichsbank.]

[In thousands of marks.]

	Dec. 31, 1913.	Dec. 31, 1914.	Dec. 31, 1915.	Dec. 30, 1916.	Dec. 31, 1917.	Dec. 31, 1918.	Dec. 31, 1919.	Dec. 31, 1920.	Dec. 31, 1921.
ASSETS.									
Gold.....	1,169,971	2,092,811	2,445,185	2,520,473	2,008,586	2,262,219	1,083,499	1,091,636	995,392
Other metallic reserve.....	276,832	36,885	32,973	16,319	181,350	19,948	20,520	5,773	11,612
Total metallic vault reserve.....	1,446,803	2,129,696	2,477,258	2,536,792	2,189,936	2,282,167	1,104,019	1,097,409	1,007,004
Imperial Treasury and Loan									
Bank certificates.....	46,202	875,000	1,287,865	422,089	1,314,790	5,206,919	14,025,257	23,416,674	6,963,607
Notes of other banks.....	12,765	5,312	3,130	1,394	674	2,908	1,074	1,624	2,084
Bill discounts.....									
Treasury bills.....	1,490,749	3,638,568	5,893,314	9,609,767	14,596,106	27,415,712	41,744,534	60,634,023	113,302,660
Advances on collateral.....	94,473	22,876	12,939	8,728	5,637	9,940	9,940	4,438	8,476
Securities.....	403,410	33,972	83,726	83,726	89,131	156,623	153,953	183,590	195,112
Sundry assets.....	225,135	215,013	272,229	784,125	2,091,394	2,386,060	2,435,395	9,725,125	8,220,979
Total.....	3,719,537	7,218,411	9,908,110	13,447,674	20,685,172	37,519,496	56,515,305	95,065,883	149,790,722
LIABILITIES.									
Capital paid in.....	180,000	180,000	180,000	180,000	180,000	180,000	180,000	180,000	180,000
Surplus.....	70,048	74,479	80,550	85,471	89,154	84,828	84,496	104,258	121,413
Notes in circulation.....	2,593,445	5,045,399	6,917,922	8,054,652	11,467,749	22,197,315	35,095,369	63,805,008	113,639,464
Other liabilities payable on de-									
mand.....	793,120	1,756,997	2,359,012	4,564,206	8,650,389	13,280,398	17,071,857	22,327,114	32,905,673
Sundry liabilities.....	52,924	161,126	370,626	563,345	896,897	1,776,455	3,463,583	3,649,503	2,944,172
Total.....	3,719,537	7,218,411	9,908,110	13,447,674	20,685,172	37,519,496	56,515,305	95,065,883	149,790,722
Ratio of metallic reserve to de-									
posit and notes liabilities com-									
bined—per cent.....	42.72	31.31	26.70	20.10	13.26	6.43	2.10	1.20	.69

* Of this 1,061,754,000 marks is bills and checks and 132,330,906,000 marks discounted Treasury bills.

* Of this 7,991,545,000 marks is Government deposits and 23,314,330,000 marks private deposits.

The Autonomy of the Reichsbank.

From the Federal Reserve Bulletin, vol. 8, pp. 688-689 (June, 1922).

In connection with the fulfillment of the demands presented to the German Government by the Reparations Commission on March 22, a bill was introduced in the Reichstag on April 5th, inaugurating certain reforms in the regulations which govern that institution. The bill passed its third reading on May 20th and was then made law. This new statute changes certain paragraphs in the bank act of March 14, 1875, which relate to the administration of the Reichsbank and its right of note issue. Important changes were made in paragraph 27 of the act and it now reads "the president of the bank and the members of the directorium are appointed by the President of the Empire for life. . . . The president is appointed from a list of three names which is made up by a committee consisting of nine members, three of whom are elected by the Federal Council (Reichsrat), three by the Federal Economic Ministry (Reichswirtschaftsrat), and three by the central committee of the bank." Paragraph 25, which deals with the election of the curatorium, has been changed so as to read:

The right to supervise the Reichsbank, formerly exercised by the Government, is now exercised by the curatorium which consists of the Chancellor as chairman, the Minister of Finance and the Minister of Economics (Reichswirtschafts Minister) as vice-chairmen, and of six other members. Three of these members are appointed by the President of the Empire after consulting with the Federal Economic Ministry, and the rest are appointed by the Federal Council. The curatorium shall meet at least four times a year and may be convoked at any time by the Chancellor. The Chancellor is bound to convoke the curatorium at the request of one of the vice-chairmen or of three other members of the curatorium.

The president and the members of the Reichsbank directorium are bound to appear at the meetings of the curatorium if they are so requested and to report on the condition of the bank. The directorium is responsible to the curatorium for all bank operations.

Paragraph 31 provides for the election of the central committee of the Reichsbank. This committee represents the interests of the shareholders and the Government in the administration of the bank. It consists of 20 members and an equal number of alternates. Ten members and alternates are elected from those shareholders who own at least 9,000 marks' worth of stock; the rest include at least four representatives of the employees of banks, industry, and commerce, and at least one representative of savings banks, co-operatives, and trade.

The most important change which has been made in the Reichsbank law occurs in paragraph 26, which deals with the right of note issue and which now reads: "The principles regarding the right of note issue are

established by the Reichsbank directorium after consultation with the Federal Economic Ministry." This law makes the Reichsbank in large measure independent of the supervision of the Government and places the power of note issue entirely in the hands of the bank directorium. What practical consequences it will have at the present time will depend largely upon the appointments to the newly established boards.

Banking Expansion in Great Britain.

From the Federal Reserve Bulletin, vol. 7, pp. 295-297 (March, 1921).

Below is given a consolidated statement of the condition of the five big joint-stock banks of Great Britain at the close of each year, 1913 to 1920, also the statement of condition on the same dates of each of these banks and, for the years 1913 to 1917, of the three largest banks absorbed by the big banks during the period.

War and post-war expansion in British banking is indicated by the growth of deposits, which increased more than threefold—from 525,000,000 on December 31, 1913, to 1,628,000,000 on December 31, 1920, the largest increase under this head occurring during the year 1918. Corresponding to this large increase in deposit liabilities there is an increase in investments in British Government securities from 30,000,000 to 262,000,000 and an increase in advances, largely on war stock and other Government war obligations, from 273,000,000 to 768,000,000. Bills of exchange or discounts, which the London Economist believes include treasury bills, show a considerable shrinkage during the early period of the war, and in December, 1915, stood at about £41,000,000, compared with 62,000,000 in 1913 and 67,000,000 in 1914. Since then the item has increased almost sevenfold, reaching a total of 282,000,000 at the close of 1920.

As bearing upon the volume of foreign trade transactions, the changes in the amount of acceptances and indorsements are interesting. At the close of December, 1913, this item stood at about 36,000,000. At the close of the following year it had declined to 29,000,000, and at the close of 1918 it stood at 45,000,000. A year later it had gone up to 104,000,000, which is the high figure for the period. At the end of 1920 the item showed a decrease to 79,000,000, this decrease reflecting in a general way the relative shrinkage in the amount of foreign trade financing. For the period under review the "big five" banks show a large increase in capitalization, due partly to absorption of and merger with other commercial banks. Their paid-in capital shows an increase from 27,000,000 at the close of 1913 to 58,000,000 at the close of 1920, while their reserves show an even larger increase from about 19,000,000 to 47,000,000.

Statements of Condition of the British Banks.

TOTAL FOR THE "BIG FIVE" BANKS.
[In thousands of pounds.]

	1913	1914	1915	1916	1917	1918	1919	1920
ASSETS.								
Cash in hand and with the Bank of England..	87,212	137,750	136,049	195,484	183,159	237,500	255,481	274,137
Money at call and at short notice.....	68,716	51,867	38,112	58,281	119,943	154,899	82,884	89,842
Investments:								
British Government securities:.....	30,358	52,544	184,475	198,376	216,606	236,042	291,669	261,732
Other investments.....	40,142	45,010	38,545	29,125	28,239	33,711	33,090	45,024
Bills of exchange.....	61,637	67,314	41,058	88,922	134,942	260,620	213,920	281,659
Advances.....	273,435	308,901	285,911	288,359	335,083	432,631	712,868	767,586
Acceptances and indorsements.....	36,192	29,001	39,823	46,319	42,020	45,200	104,356	78,384
Sundry assets.....	13,143	14,532	14,475	14,900	15,008	24,652	17,345	19,419
Total.....	610,835	707,918	778,448	919,766	1,073,000	1,425,345	1,741,623	1,818,283
LIABILITIES.								
Capital paid in.....	27,398	28,838	28,838	29,832	30,889	35,724	42,068	58,404
Reserve.....	18,825	19,575	19,575	19,975	21,944	34,453	41,081	46,992
Current, deposit, and other accounts.....	524,753	626,378	686,473	819,883	967,981	1,304,811	1,548,813	1,628,375
Acceptances and indorsements.....	36,192	29,001	39,823	46,319	42,020	45,200	104,356	79,384
Sundry liabilities.....	3,677	4,126	3,739	3,757	10,166	5,067	4,405	5,128
Total.....	610,835	707,918	778,448	919,766	1,073,000	1,425,345	1,741,623	1,818,283

LLOYD'S BANK (LTD.).
[In thousands of pounds.]

	1913	1914	1915	1916	1917	1918	1919	1920
ASSETS.								
Cash in hand and with the Bank of England.....	16,177	24,634	30,420	38,115	34,685	48,768	57,587	51,153
Money at call and at short notice.....	8,617	10,073	3,944	6,480	7,192	15,571	14,622	14,748
Investments:								
War loan and other British Government securities.....	4,863	7,825	36,060	35,775	34,228	53,630	66,232	64,041
Other investments.....	5,530	8,308	6,766	6,107	3,532	8,892	9,533	9,535
Bills of exchange.....	10,830	13,490	4,042	15,367	29,907	74,346	57,482	76,037
Advances.....	50,871	56,440	55,098	55,857	61,467	81,072	133,764	151,079
Acceptances and indorsements.....	7,462	6,226	9,497	11,298	10,375	14,765	32,060	17,868
Sundry assets.....	2,269	3,083	2,883	2,833	2,702	3,647	3,804	4,142
Total.....	106,619	133,009	148,610	171,632	194,082	300,685	377,114	388,403
LIABILITIES.								
Capital paid in.....	4,209	5,009	5,009	5,009	5,009	8,954	9,430	14,138
Reserve.....	3,000	3,600	3,600	3,600	4,000	9,000	9,675	10,000
Current, deposit, and other accounts.....	91,512	117,653	130,017	151,368	174,968	266,808	324,712	345,029
Acceptances and indorsements.....	7,436	6,226	9,497	11,298	10,375	14,765	32,060	17,868
Sundry liabilities.....		516	487	447	630	1,158	1,227	1,368
Total.....	106,619	133,009	148,610	171,632	194,082	300,685	377,114	388,403

BARCLAY & CO. (LTD.).
[In thousands of pounds.]

	1913	1914	1915	1916	1917	1918	1919	1920
ASSETS.								
Cash in hand and with the Bank of England...	9,155	11,930	14,181	22,983	24,527	43,923	65,174	61,710
Money at call and at short notice.....	6,812	5,099	4,470	5,827	10,172	21,325	20,032	21,313
Investments:								
British Government securities and bank								
stock.....	5,177	8,129	19,735	22,205	21,618	40,792	53,136	47,164
Other investments.....	6,037	6,613	6,174	4,835	4,649	9,768	9,205	16,772
Bills of exchange.....	9,602	9,649	3,721	16,880	28,089	47,442	30,253	44,861
Advances.....	27,340	29,390	28,408	38,204	44,201	78,855	130,095	155,561
Acceptances and Indorsements.....	437	638	2,230	2,981	2,151	4,212	13,589	10,228
Sundry assets.....	1,882	1,815	1,853	2,451	2,606	11,716	3,984	4,249
Total.....	66,442	73,263	80,772	116,947	138,013	258,033	325,468	361,858
LIABILITIES.								
Capital paid in.....	3,600	3,600	3,600	4,594	4,594	7,289	8,820	15,592
Reserve.....	1,600	1,600	1,600	2,200	2,200	6,000	7,000	8,250
Current deposit and other accounts.....	60,805	67,425	73,342	107,292	129,088	239,382	296,059	327,788
Acceptances and Indorsements.....	437	638	2,230	2,981	2,151	4,212	13,589	10,228
Sundry liabilities.....						1,160		
Total.....	66,442	73,263	80,772	116,947	138,013	258,033	325,468	361,858

LONDON JOINT CITY AND MIDLAND BANK (LTD.).

[In thousands of pounds.]

	1913	1914	1915	1916	1917	1918	1919	1920
ASSETS.								
Cash in hand and with the Bank of England...	17,241	33,197	30,881	47,974	44,110	63,756	68,267	70,196
Money at call and at short notice.....	11,947	9,865	8,651	8,844	31,003	67,811	18,439	18,492
Investments:								
British Government securities.....	3,247	5,428	33,947	33,400	33,117	57,464	84,217	50,279
Other investments.....	4,578	7,649	4,883	3,791	3,891	4,897	3,846	4,744
Bills of exchange.....	11,791	14,085	9,962	23,337	35,053	39,249	52,890	57,672
Advances.....	51,309	62,425	65,921	63,369	81,156	113,432	178,556	189,720
Acceptances and indorsements.....	6,163	7,211	9,158	7,221	8,827	13,146	20,015	27,850
Sundry assets.....	2,308	2,679	2,760	2,753	2,837	3,762	3,619	3,884
Total.....	108,534	142,540	166,163	191,189	239,994	363,517	418,849	422,837
LIABILITIES.								
Capital paid in.....	4,349	4,781	4,781	4,781	5,189	7,173	8,417	10,860
Reserve.....	3,700	4,000	4,000	4,000	4,343	7,173	8,417	10,860
Current, deposit, and other accounts.....	93,533	123,733	147,761	174,621	220,551	334,898	371,743	371,842
Acceptances and indorsements.....	6,163	7,211	9,158	7,221	8,827	13,146	20,015	27,850
Sundry liabilities.....	539	815	473	7,596	1,084	1,127	1,257	1,425
Total.....	108,534	142,540	166,163	191,189	239,994	363,517	418,849	422,837

LONDON COUNTY WESTMINSTER AND PARR'S BANK (LTD.)
[In thousands of pounds]

	1913	1914	1915	1916	1917	1918	1919	1920
ASSETS.								
Cash in hand and with the Bank of England.....	13,757	22,525	23,250	32,385	25,198	47,477	58,767	49,124
Money at call and at short notice.....	12,383	5,635	5,142	7,872	26,983	36,970	18,794	22,533
Investments:								
British Government securities.....	5,365	10,551	32,157	32,383	32,409	45,503	59,849	51,940
Other investments.....	3,349	4,286	3,576	4,562	4,841	3,882	5,210	6,044
Bills of exchange.....	15,800	18,369	11,352	14,337	24,288	60,520	49,351	60,536
Advances.....	44,089	46,617	39,941	36,117	40,800	80,973	128,001	130,539
Acceptances and indorsements.....	7,656	4,276	5,022	6,979	5,449	9,276	23,704	19,034
Sundry assets.....	1,849	1,717	1,856	1,709	1,789	2,930	3,030	3,479
Total.....	104,248	113,986	122,296	135,344	161,757	287,540	346,796	343,434
LIABILITIES.								
Capital paid in.....	3,500	3,500	3,500	3,500	4,149	6,831	8,504	8,504
Reserve.....	4,250	4,000	4,000	4,000	4,726	7,430	8,750	9,004
Current, deposit, and other accounts.....	88,214	101,582	109,161	120,255	142,268	262,858	304,548	305,381
Acceptances and indorsements.....	7,656	4,276	5,022	6,979	5,449	9,276	23,704	19,034
Sundry liabilities.....	7,628	628	613	610	5,105	1,145	1,290	1,511
Total.....	104,248	113,986	122,296	135,344	161,757	287,540	346,796	343,434

NATIONAL PROVINCIAL AND UNION BANK OF ENGLAND (LTD.).

[In thousands of pounds]

	1913	1914	1915	1916	1917	1918	1919	1920
ASSETS.								
Cash in hand and with the Bank of England.....	10,816	16,125	11,365	16,450	17,295	23,576	35,686	41,954
Money at call and at short notice.....	7,400	3,449	4,654	5,493	8,101	13,222	10,997	11,851
Investments:								
British Government securities.....	6,322	7,311	24,084	35,643	37,712	38,653	48,235	48,303
Other investments.....	6,654	7,050	6,891	4,795	4,691	6,272	5,296	5,129
Bills of exchange.....	41,019	46,239	38,832	41,893	49,257	26,660	23,944	42,753
Advances.....	824	683	1,310	3,032	1,983	78,200	140,362	140,897
Acceptances and indorsements.....	764	835	1,861	843	824	3,891	5,968	4,404
Sundry assets.....						2,897	2,908	3,665
Total.....	73,799	80,692	88,497	108,149	119,863	215,570	273,396	301,751
LIABILITIES.								
Capital paid in.....	3,000	3,000	3,000	3,000	3,000	5,477	7,807	9,310
Reserve.....	2,000	2,000	2,000	1,800	2,100	4,850	7,239	8,878
Current, deposit, and other accounts.....	67,883	74,916	81,590	100,219	112,597	200,865	251,751	278,335
Acceptances and indorsements.....	824	683	1,810	3,032	1,983	3,891	5,968	4,404
Sundry liabilities.....	92	93	97	98	183	487	631	824
Total.....	73,799	80,692	88,497	108,149	119,863	215,570	273,396	301,751

Annual Reports of the Joint-Stock Banks.

From the Federal Reserve Bulletin, vol. 8, pp. 415-417 (April, 1922).

Reports of the British banks for the end of 1921 were surprisingly favorable. They showed that in spite of the fact that the preceding year had been one of heavy liquidation, the condition of the banks, both as regards profit and loss and current accounts, was very similar to that of the preceding year when liquidation had been in progress only a few months. Although it is impossible to analyze the position of the banks with exactitude, because of the inadequacy of the published statistics, the outstanding facts are to be noted. In discussing recent bank statements in the February issue of the London Bankers' Magazine the editor states:

One or two among the provincial banking institutions have seen fit to increase their rates of dividend distribution for the past year, these instances occurring apparently mainly in those cases where particularly heavy amounts had been written off in respect of investments depreciation in the last few years, with the result that not only have profits sufficed to set aside very substantial sums required as provision for bad and doubtful debts, and still leave a handsome margin, but the rise in security values has permitted sums previously set aside to investment reserve funds to be brought back and added to visible general reserve funds. The more general practice, however, has been to leave the past alone, to be thankful for the rise in Government securities, and to add further sums to the amounts previously written off or added to undisclosed reserves for "contingencies," an all-embracing word which is more or less of postwar adoption. . . . It is generally employed in regard to internal reserves which are not disclosed in the balance sheet, although the sums in question are allocated from the published profits. Before the war it was usual to make all additions to internal reserves before arriving at the figure to be published as profit, but the discovery of contingencies has enabled internal reserves to be built up without unduly cutting down the amount of the published profits. It has also enabled auditing difficulties to be got over, for sums written off the book value of investments could not afterward be written in again if securities appreciated, but a reserve against contingencies may be earmarked at one period against investment depreciation, and when no longer required for that purpose may go to form additional provision for bad debts.

The percentage of net profit to paid-up capital in the case of the five largest banks ranged from 14 to 24 per cent for the year. The disposition of profits in the case of the London Joint City and Midland Bank was as follows:

Balance from preceding year.....	£741,619
Net profits, 1921	<u>2,454,083</u>
Total	<u>3,195,702</u>
Dividend, 18 per cent per annum less income tax	1,368,449
Reserve for future contingencies	750,000
Bank premises redemption fund	300,000
Balance to be carried forward to next account	<u>777,253</u>
Total	<u><u>3,195,702</u></u>

In other words, in the case of this bank the contingency fund took approximately 30 per cent of the net profits for the year and dividends required 55 per cent. In the case of the National Provincial and Union Bank slightly less than 20 per cent of the net profits went to the contingency fund and 70 per cent to dividends. In the following table a summary is given of the net profits of the five big banks during the last two years and the ratio of net profits in 1921 to paid-up capital.

Bank.	Capital paid up, Dec. 31, 1921.	Net profits 1920.	Net profits, 1921.	Per cent of net profits, 1921, to paid-up capital Dec. 31, 1921.
Barclay & Co.	£15,592,372	£2,927,525	£2,201,652	14
Lloyds	14,372,956	3,237,742	2,529,124	18
London Joint City & Midland	10,860,852	2,831,861	2,454,083	23
National Provincial & Union	9,309,416	2,762,514	2,054,686	22
London County West- minster & Parr's ...	9,003,718	2,915,708	2,167,845	24

The dividends declared by all of these banks are the same as last year, namely, Barclay & Co., 10 per cent per annum on "A" shares and 14 per cent per annum on "B" and "C" shares, Lloyds, $16\frac{2}{3}$ per cent per annum; London Joint City and Midland, 18 per cent per annum; National Provincial and Union, 16 per cent per annum; London County Westminster and Parr's, 20 per cent on £20 shares and $12\frac{1}{2}$ per cent on £1 shares.

Deposits of the five big banks were approximately the same at the end of December as a year earlier, while loans and advances were appreciably lower and discounts appreciably higher. It is impossible to state the proportion of total discounts that are based upon treasury bills, but this ratio has probably increased during the year, since commercial bills have been relatively scarce. In this connection the Bankers' Magazine says:

It is a great pity that more of the leading banks have not seen their way to stating in their balance sheets the precise amount of treasury bills held. Such information is very valuable from a statistical point of view, and from that of the banks it would seem to be an advantage rather than the reverse to show the public how much of the discounts is represented by bills whose safety is beyond all question. Treasury bills, in fact, are so readily convertible into cash that they might well be ranked as superior to money at call as regards degree of liquidity. Under our present system treasury bills are not very far removed from an interest-bearing currency, for the Bank of England cannot very well impose limitations as to their rediscount.

In these remarks both the strength and weakness of treasury bills as bank assets are touched upon. They are more liquid than most commercial paper, but they are not self-liquidating and therefore tend to be inflationary. In the table below the deposits, loans, and advances, and bills discounted of the five big banks at the end of December, 1921 and 1920, are itemized:

[Millions of pounds sterling.]

	Deposits.		Loans and advances.		Bills discounted.	
	1920	1921	1920	1921	1920	1921
Barclay & Co.	328	331	156	133	45	75
Lloyds	345	348	151	131	76	91
London Joint City & Midland	372	375	190	177	58	72
National Provincial & Union.	278	273	141	127	43	56
London County Westminster & Parr's	305	318	131	115	60	102

Investments of the banks show a slight reduction during the year, but the distribution of holdings between Government and private investments appear to be similar. In the case of the London Joint City and Midland Bank, of total investments amounting to a value of £56,759,000, £55,365,000 were war loans or other British Government securities. In the case of Barclay & Co.'s bank the proportion was not quite so high, but British Government securities amounted to £48,125,000 out of a total of £55,656,000.

Lloyds Bank.

Lloyds Bank in London has a board of directors of thirty-three with a chairman and deputy chairman.

The head office.—The head office has the following organization:

Director and General Manager.

Five Joint General Managers.

Six Assistant General Managers (three in London, one each in Birmingham, Newcastle, and Halifax).

Three General Managers' Assistants.

Treasurer.

Treasurer's Assistant.

Chief Inspector.

Deputy Chief Inspector.

Thirty-five Inspectors.

Secretary.

Advance Department.

Chief Controller.
Eight Controllers.
Assistant Controller.

Branches Stock Office.

Manager.
Assistant Manager.

Chief Accountant's Department.

Chief Accountant.
Assistant Chief Accountant.
Three Accountants.

Colonial and Foreign Department.

General Manager's Assistant.
Two Managers.
Exchange Manager.
Two Sub-Managers.

Information Department (Credit Department).

Manager.

Legal Department.

Principal.

Premises Department.

Premises Secretary.

Secretary's Department.

Registrar.

Staff Department.

Staff Secretary.

Trustee Department.

Manager.
Two Assistant Managers.

Capital and Counties Sections.

Two Managing Directors.
Two Assistant Managers.

Advance Department.

Chief Controller.
Four Controllers.
Assistant Controller.

Branch offices.—Lloyds Bank has about 1,600 offices in England and Wales. There are 55 offices in London and 39 in Birmingham. It is affiliated with the National Bank of Scotland, Limited, which has about 130 offices in Scotland, and also with the London and River Plate Bank, which has branches in Paris, Lisbon, and Antwerp, an agency in New York, and numerous offices in South America. Besides this, there is an auxiliary Lloyds and National Provisional Foreign Bank, Limited, with twelve offices in Europe.

Like most of the big banks in London, part of the growth of Lloyds Bank has been due to consolidation.

With this bank have been incorporated the undermentioned companies and firms:

- In 1865, Lloyds & Co., Birmingham Old Bank (established 1765).
- In 1865, Moilliet & Sons, Birmingham.
- In 1865, P. & H. Williams, Wednesbury Old Bank.
- In 1866, Stevenson, Salt & Co., Stafford Old Bank (established 1737).
- In 1866, Warwick & Leamington Banking Company.
- In 1868, A. Butlin & Son, Rugby Old Bank (established 1791).
- In 1872, R. & W. F. Fryer, Wolverhampton Old Bank.
- In 1874, Shropshire Banking Company.
- In 1879, Coventry and Warwickshire Banking Company.
- In 1880, Beck & Co., Shrewsbury and Welshpool Old Bank.
- In 1884, Barnetts, Hoares & Co., London (established 1677).
- In 1884, Bosanquet, Salt & Co., London (established 1796).
- In 1888, Pritchard, Gordon & Co., Brosely and Bridgnorth.
- In 1889, Birmingham Joint Stock Bank, Limited.
- In 1889, Worcester City and County Banking Company, Limited.
- In 1890, Wilkins & Co., Old Bank, Brecon, Cardiff, etc. (established 1778).
- In 1890, Beechings & Co., Tunbridge Old Bank, Tunbridge Wells, Hastings, etc.
- In 1891, Praeds & Co., London (established 1802).
- In 1891, Cobb & Co., Margate, etc. (established 1785).
- In 1891, Hart, Fellows & Co., Nottingham (established 1808).
- In 1892, R. Twining & Co., London (established 1824).
- In 1892, Bristol and West of England Bank, Limited.
- In 1893, Cürteis, Pomfret & Co., Rye (established 1790).
- In 1893, Herries, Farquhar & Co., London (established 1770).
- In 1894, Bromage & Co., Old Bank, Monmouth (established 1819).
- In 1895, Paget & Co., Leicester Bank (established 1825).
- In 1897, County of Gloucester Bank, Limited.

- In 1897, Williams & Co., Chester, etc. (established 1792).
- In 1898, Jenner & Co., Sandgate & Shorncliffe Bank.
- In 1899, Burton Union Bank, Limited.
- In 1899, Stephens, Blandy & Co., Reading, etc. (established 1790).
- In 1900, Vivian, Kitson & Co., Torquay Bank (established 1832).
- In 1900, Liverpool Union Bank, Limited.
- In 1900, Cunliffes, Brooks & Co., Manchester, etc. (established 1792).
- In 1900, Brooks & Co., London.
- In 1900, William Williams Brown & Co., Leeds (established 1813).
- In 1900, Brown, Janson & Co., London (established 1813).
- In 1902, Bucks and Oxon Union Bank, Limited.
- In 1902, Pomfret, Burra & Co., Ashford Bank (established 1791).
- In 1903, Hodgkin, Barnett & Co., Newcastle-upon-Tyne, etc.
- In 1903, Grant & Maddison's Union Banking Co., Limited.
- In 1905, Hedges, Wells & Co., Wallingford Bank (established 1797).
- In 1906, Devon & Cornwall Banking Co., Limited.
- In 1908, Lambton & Co., Newcastle-upon-Tyne, etc. (established 1788).
- In 1909, David Jones & Co., Llandovery, etc. (established 1800).
- In 1911, Hill & Sons, West Smithfield, E. C., etc. (established 1825).
- In 1912, Peacock, Willson & Co., Sleaford, etc. (established 1792).
- In 1914, Wilts and Dorset Banking Co., Limited (established 1835).
- In 1918, Capital and Counties Bank, Limited (established 1834).
- In 1919, West Yorkshire Bank, Limited (established 1829).
- In 1921, Fox, Fowler & Co. (established 1787).

Activities.—Current accounts are opened upon the terms usually adopted by bankers. Deposits are received at interest, subject to notice of withdrawal, or by special agreement. Purchases and sales of stocks are effected through members of the Stock Exchange, and securities are received for safe custody. Coupons, dividends, pay warrants, etc., are collected, foreign moneys exchanged, periodical payments made, and every description of banking business conducted. A savings bank department is available for the deposit of small savings.

The bank has correspondents and agents throughout the British Isles, to whom credits can be paid by its customers and others for transmission. It has also a large number of colonial and foreign agents, and undertakes the collection of foreign bills and cheques, and purchases approved bills. Letters of credit and circular notes are issued, and foreign currency drafts, telegraphic transfers and letter payments, available in all parts of the world, can be obtained from the principal branches.

The bank is prepared, in approved cases, to act as executor and

trustee of wills, trustee of settlements, trustee of debenture stock issues, etc., for its customers. Copies of the regulations can be obtained from any of the offices.

German Banking During 1921.

From the Federal Reserve Bulletin, vol. 8, pp. 949-951 (August, 1922).

The financial statements of the largest German banking institutions, made public at the end of June, together with the annual report of the Reichsbank, show to what extent Germany's economic situation has differed from that in other countries. While the rest of the world went through a period of readjustment and deflation, which caused heavy losses to both banks and mercantile institutions, Germany witnessed one of the greatest boom periods since the "Gründerjahre." The flood of new paper notes, closely followed by a rapid rise in prices, increased the business activities of the banks, with the result that items such as deposits and loans advanced into billions of marks and the turnover into trillions. The issue of 32,000,000,000 new securities further increased the business of the banks.

The increase in the amount of the various items in the case of certain banks is partly due to the concentration of banking in fewer hands, a movement which continued throughout the year. The larger banking institutions absorbed a number of smaller banks and replaced them by their own branches. The most important merger which occurred during the year is the fusion of the Bank für Handel und Industrie (Darmstädter Bank) with the National Bank für Deutschland. The final merged institutions have a combined capital and surplus of 1,050,000,000 marks and operate under the name of "Darmstädter and National Bank."

The principal items of the combined statement of the largest German banking institutions, presented below, depict very well the unsound and "feverish" economic situation prevailing in Germany throughout the entire year.

FINANCIAL STATEMENTS OF PRINCIPAL GERMAN BANKS, DECEMBER 31, 1921.

[In millions of marks.]

	Deutsche Bank		Disconto-Gesellschaft		Dresdner Bank		Darmstädter Bank		National Bank		Commerz und Privat Bank	
	1921	Increase Over 1920	1921	Increase Over 1920	1921	Increase Over 1920	1921	Increase Over 1920	1921	Increase Over 1920	1921	Increase Over 1920
ASSETS												
Cash, and with Reichsbank.....	1,470	269	2,531	1,433	839	169	714	277	683	348	345	123
Other bank deposits.....	3,863	2,678	3,340	2,163	2,734	1,839	2,626	2,203	566	353	578	394
Bills and treasury notes.....	24,244	8,216	8,848	2,648	3,480	1,712	3,670	674	1,201	598	3,012	606
Other quick assets.....	1,222	394	839	546	1,961	1,369	2,685	2,212	1,074	1,074	2,422	1,772
Total quick assets.....	30,808	11,586	15,588	6,783	13,053	4,835	9,695	5,367	4,070	2,375	6,337	2,685
Non-liquid assets.....	8,027	5,515	6,678	3,211	3,500	2,928	4,648	2,966	1,580	665	3,243	1,682
LIABILITIES												
Capital stock.....	400		400	90	550	290	368	148	262	112	350	150
Surplus.....	450	72	240	100	361	281	196	149	55	25	322	272
Deposits, etc.....	38,835	17,101	22,266	10,153	19,454	7,763	14,345	8,274	5,651	3,040	3,601	4,368
Percentage of quick assets to liabilities	76	85	66	69	62	70	49	64	44	45	41	58
PROFIT AND LOSS STATEMENT												
Miscellaneous earnings.....	465	195	3,052	123	323	148	223	111	105	60	141	60
Earnings on interest.....	695	251	364	144	478	248	359	204	160	94	311	183
Gross profit.....	1,172	449	679	275	836	412	577	314	267	155	453	2,422
Net profit.....	278	104	222	68	203	96	89	34	78	40	98	50
Dividends (per cent).....	24	18	20	16	16	12	14	10	14	10	16	12
Reserves.....	130	504	99	29	50	20	50	20	50	30	30	10
Turnover, in billions.....	2,125	844	1,463	623	1,664	1,574					737	355

The capital and surplus of all banks, although largely increased, were entirely out of proportion to deposits. This situation impaired to a large extent the liquidity of practically all banks. The percentage of quick assets to quick liabilities decreased and reached a dangerously low point in some institutions. This decrease in the liquidity is the more remarkable, as it occurred for the first time in many years.

The increase in deposits, coupled with a great demand for capital, increased the earnings and expenditures of all banks. The bulk of the income was derived from interest and commissions charged to the customers, who at the prevailing stage of business activity could easily bear the burden. The ever-increasing expenditures of the banks must ultimately prove fatal when the income decreases more rapidly than expenditures can be reduced. German banks were perfectly aware of the unsound conditions upon which their earnings are based, and made ample provisions for the coming storm. Their dividends, although high, were small if compared with the huge sums set aside for reserves and the large depreciation charges made during the year.

A more detailed analysis of the assets of the banks shows one wholesome fact, namely, the increasing tendency toward private as against government financing. Government paper held by banks decreased steadily and released funds for private business transactions. The large banks were unwilling to discount treasury bills of the State to the same extent as in former years, which resulted in ever-increasing holdings of treasury notes by the Reichsbank.

Another item of interest is the rapid increase of deposits carried with other banks. Such deposits undoubtedly consist to a large extent of funds deposited with foreign banks by customers who prefer to hold them abroad. From the available data, however, it is impossible to determine the amount of funds kept abroad, since both domestic and foreign deposits are combined in one item. A separation of these two classes of funds would be very desirable, inasmuch as the foreign deposits are not so liquid as the domestic, which can be withdrawn upon demand.

The resumption of business relations with foreign countries continued steadily during the year. New affiliations were made abroad, especially in Holland. The branches in London and in other former enemy countries were not reopened, so that a large percentage of Germany's foreign trade which before the war would have been financed through London was financed through Amsterdam. The foreign business of the banks consisted largely in providing foreign credits to German importers and in the buying and selling of foreign exchange. The latter was carried on very extensively and caused the failure of at least one important banking institution, the Pfälzische Bank.

Annual Report of the Reichsbank.

The report of the Reichsbank for the past year reflects the same situation as do the statements of the large commercial banks. The steady decline in the value of the mark both at home and abroad, coupled with the huge deficits of the Government and the increasing unfavorable balance of trade, created requirements which the Reichsbank met by the issue of paper notes. During the year the number of notes in circulation rose rapidly and increased by 44,834,000,000 marks. The tremendous inflation and the depreciation of the currency also accounted for the huge turnover figures of the Reichsbank, which during 1921 reached 20 trillion marks. The increase of notes outstanding and the turnover for the last four years can be seen from the following figures:

Year.	Notes in circulation.	Turnover.
1918	22,187,000,000	3,342,900,000,000
1919	35,698,000,000	.....
1920	68,805,000,000	12,770,736,000,000
1921	113,639,000,000	20,090,601,000,000

Except for the great increase in the amounts of the various items, especially in the number of discounted treasury bills and in the volume of income and expenditures, no important changes took place.

The metallic reserves fluctuated only slightly and stood at a monthly average of 1,073,345,000 gold marks, as against 1,104,037,000 in 1920. The gold reserves, however, decreased from 1,091,600,000 in December, 1920, to 995,400,000 in December, 1921, or by 96,200,000 gold marks. This decline was largely due to the use of 68,000,000 gold marks for reparations payments.

Discounted treasury notes held by the bank rose from 57,626,000,000 gold marks at the beginning of the year to 132,330,000,000 at the end. This upward movement runs parallel with changes in the floating debt of the Reich, which increased from 152,000,000,000 marks at the beginning of 1921 to 247,000,000,000 in December of the same year. The increase in the holdings of treasury bills by the Reichsbank is due to the inability of the public or banks further to absorb treasury bills. At the beginning of 1921, 62 per cent of the total floating debt was held by the public, whereas at the end of the year only 46 per cent was so held.

Gross profits of the Reichsbank for the year were 9,800,000,000 marks, as against 7,800,000,000 in 1920 and 4,500,000,000 marks in 1919. The sources of these huge earnings were the large amount of discounted treasury bills held in the portfolios of the bank, the profits from foreign

exchange transactions, and the sale of 24,000 kilograms of gold to the Reich. The expenditures, including losses of 8,100,000,000 marks incurred in guaranteeing foreign currency credits for the Reich, amounted to 9,712,921,629 marks. The net profits for the year were 64,806,169 marks.

The German Disconto-Gesellschaft.

The Disconto-Gesellschaft may be taken to illustrate the German big bank. In one way it is peculiar. It is under the supervision of a group of five managers who agree to manage it for a certain share of the profits.

Balance Sheet of the Disconto-Gesellschaft December 31, 1920.

<i>Assets</i>	<i>Marks.</i>	<i>Marks.</i>
Cash, foreign coins, coupons and balances with note banks and banks of discount		1,098,831,613.64
Bills discounted and non-interest-bearing treasury certificates (a) Bills discounted and non-interest-bearing treasury certificates of the Empire and the states....	6,229,595,220.85	6,229,595,220.85
(b) Own acceptances		
(c) Own drafts		
(d) Sole bills of customers to the order of the bank..		
Balances with banks and bankers		1,177,142,550.94
Contangos and collateral loans on stock exchange securities		95,717,561.74
Advances on goods and shipments of goods secured.....		120,763,568.46
(a) By goods, shipping papers or dock warrants	92,695,989.11	
(b) By other securities	16,469,883.87	
Own securities		88,251,869.21
(a) Bonds and interest-bearing treasury certificates of the Empire and the states	10,629,442.22	
(b) Other securities eligible for securing loans at the Reichsbank and other central banks	4,913,178.33	
(c) Other securities quoted on the stock exchange...	67,451,321.38	
(d) Other securities	5,257,925.28	
Syndicate participation		77,464,947.07
Participation in the Norddeutschen Bank in Hamburg....		60,000,000.00
Participation in the Schaaffhausen'schen Bank Verein....		100,000,000.00
Permanent participations with other banks and bankers...		60,396,718.70
Loans in current accounts		3,576,751,897.99
(a) Secured	2,936,502,449.29	
Secured by securities listed on the stock exchange	1,007,185,114.96	
(b) Unsecured	640,249,448.70	
In addition, surety	526,053,967.49	
Claims on the Empire and Reichsbank on account of assuming their obligations		160,112,747.40
Securities for pensions and other foundations		4,352,254.79
Furnishings		1.00
Bank Buildings	43,021,000.00	
deducting mortgages	6,176,183.55	36,844,816.45
Other real estate:		8,140,725.62
Plots of ground in Berlin, Essen, Mainz, Mülheim and Reutlingen	8,375,725.62	
Deducting mortgage	235,000.00	
		12,894,366,493.86
<i>Liabilities.</i>	<i>Marks.</i>	<i>Marks.</i>
Paid-in capital		310,000,000.00
Legal surplus		109,000,000.00
Other surplus	31,000,000.00	
Assigned from the profit-and-loss account of 1920....	50,000,000.00	81,000,000.00
Amounts owed		12,013,647,575.50

	Marks.	Marks.
(a) Our own obligations	40,377,600.55	
(b) On behalf of customers	24,752,674.85	
(c) Balances of German banks and bankers	1,375,387,570.00	
(d) Deposits in accounts free of commission		
1. Due within 7 days	4,678,650,098.21	
2. Due from 7 days to 3 months	1,321,015,213.05	
3. Due after 3 months	439,936,568.14	6,439,601,879.40
(e) Other amounts owed		
1. Due within 7 days	3,898,050,849.04	
2. Due from 7 days to 3 months	189,917,880.58	
3. Due after 3 months	57,559,121.08	4,135,527,850.70
Acceptances		96,571,711.75
In addition		
Surety obligations	526,053,967.49	
Our own drawings	1,076,165.42	
For the account of third parties	1,076,165.42	
For obligations taken over for the account of the Empire or the Reich-bank		160,112,747.40
Welfare funds		
David Hausemann Pension Fund	5,990,072.10	
Adolph von Hausemann Foundation	444,747.50	
Schoeller Foundation	247,996.52	
Dr. Arthur Salomonsohn Foundation	53,924.45	
Dr. P. D. Fischer Foundation	46,822.60	
Other foundations for the employees of the company.	667,677.30	7,451,240.47
Unpaid dividends for earlier years		1,439,769.00
Reserve for taxes	3,010,040.00	
Assigned from the profit-and-loss account of 1920....	620,000.00	3,630,040.00
16 per cent dividend on 310,000,000 marks capital.....		49,600,000.00
Share of profits of partners, managers, deputy managers, managing clerks and employees		20,543,331.15
Share of profits of the board of directors		2,853,571.68
Reserve for providing retiring allowances for employees..		10,000,000.00
Assigned to building reserve		20,000,000.00
Balance for new account		6,516,506.91
		<hr/> 12,894,366,493.86

Condition of Commercial Banks in France.

From the Federal Reserve Bulletin, vol. 8, pp. 1062-1063 (Sept., 1922).

With a view to discovering further details of the changes in finance and trade during the first part of the year, the statements of four of the most important commercial banks are summarized below. Only the more significant items are given.

There is no uniformity in French bank statements. Under French law banks are simply corporations, and, like corporations in the United States, they may present their statements as they see fit; nor are they subject to public auditing. The banks are relatively free from legal restriction, the greatest possible latitude being allowed their managements. The want of similarity in statements makes it difficult to compare them with each other in detail, but general comparisons have considerable value in determining economic and financial conditions.

The item of cash, including cash in other banks, in the foregoing statements may seem at first rather small, but it must be remembered that the very liberal discount policy of the Bank of France makes this possible without impairing the banking structure. The accounts show in general a decrease since the first of the year, but otherwise there is not much change in the banking situation. In this it supports the deductions drawn from the statements of the Bank of France. The small, but very distinct, improvements in commerce and industry which took place during the first half of the year seem to have occurred without making a clear impression on banking statistics.

There is little reflection of the disturbance connected with the reorganization of the Banque Industrielle de Chine and the difficulties of the Société Centrale des Banques de Province. That such a great failure as that of the Banque Industrielle de Chine did not precipitate a financial crisis is due to the prompt and effective co-operation of the other great banks, the situation being not unlike that of the Banca di Sconto collapse in Italy. Altogether the matter was handled in such a way as to reflect great credit on the co-operating banks. Nevertheless, it should not be assumed that such disasters can occur without causing a severe shock to the financial structure, even though the force of the blow and its visible effects be reduced to a minimum.

CRÉDIT LYONNAIS.

[In thousands of francs.]

	Dec. 31, 1921.	May 31, 1922.
ASSETS.		
Cash.....	500,111	495,179
Portfolio and treasury bills.....	3,791,115	3,876,173
Secured loans.....	164,300	164,919
Open accounts.....	778,139	697,952
Securities.....	6,231	5,746
Sundry.....	201,648	90,929
LIABILITIES.		
Deposits.....	1,694,322	1,741,990
Open accounts.....	2,873,030	2,851,368
Collection items.....	86,369	79,790
Acceptances.....	28,489	21,616
Time deposits.....	49,953	45,141
Sundry.....	276,257	136,904
Reserve.....	200,000	200,000
Paid-in capital.....	250,000	250,000
Total resources.....	5,549,308	5,437,071

SOCIÉTÉ GÉNÉRALE POUR FAVORISER LE DÉVELOPPEMENT
DU COMMERCE ET DE L'INDUSTRIE EN FRANCE.

	Dec. 31, 1921.	May 31, 1922.
ASSETS.		
Cash.....	362,410	433,353
Portfolio and treasury bills.....	3,433,841	3,397,125
Reports ¹	8,213	4,039
Secured loans.....	242,947	204,807
Open accounts.....	1,245,943	1,253,167
Securities.....	56,960	51,634
Participations.....	38,848	37,925
Unpaid capital.....	250,000	250,000
LIABILITIES.		
Capital.....	500,000	500,000
Reserve.....	53,070	54,324
Checking accounts.....	1,145,348	1,164,292
Time deposits.....	145,672	129,986
Acceptances.....	86,677	68,599
Open accounts.....	3,821,125	3,781,015
Total resources.....	5,758,310	5,718,592

¹ When itemized separately, the term "reports" usually refers to loans on Bourse transactions.

COMPTOIR NATIONAL D'ESCOMPTE.

	Dec. 31, 1921.	May 31, 1922.
ASSETS.		
Cash.....	398,271	294,754
Portfolio and treasury bills.....	2,651,291	2,861,994
Reports.....	2,405	2,255
Correspondents.....	173,767	156,852
Open accounts.....	330,025	324,677
Securities.....	2,497	2,144
Participations.....	3,100	3,100
Secured loans.....	163,579	158,353
Acceptances.....	72,483	74,744
Sundry.....	125,487	48,463
Agencies outside of Europe.....	16,588	27,819
LIABILITIES.		
Checking accounts.....	1,982,427	2,064,399
Open accounts.....	1,358,410	1,359,061
Time deposits.....	26,457	25,570
Acceptances.....	72,804	75,665
Sundry.....	189,883	108,466
Reserve.....	68,677	70,312
Capital.....	250,000	250,000
Total resources.....	4,036,650	4,042,311

SOCIÉTÉ GÉNÉRALE DE CRÉDIT INDUSTRIEL ET COMMERCIAL.

	Dec. 31, 1921.	May 31, 1922.
ASSETS.		
Cash.....	37,537	29,627
Portfolio and treasury bills.....	431,284	378,486
Open accounts.....	44,502	63,431
Reports.....	2,135	1,069
Secured loans.....	21,707	20,755
Acceptances.....	3,000	3,067
Securities.....	66,363	65,873
Sundry.....	361	233
LIABILITIES.		
Checking accounts.....	95,384	107,483
Open accounts.....	349,589	320,183
Deposits.....	78,580	59,252
Acceptances.....	3,000	3,315
Sundry.....	17,260	13,714
Rediscounts.....	3,480	3,480
Reserve.....	29,000	30,000
Capital.....	100,000	100,000
Total resources.....	714,433	681,489

The Comptoir d'Escompte.

The Comptoir National d'Escompte may be taken to illustrate the big French bank. It is run by three managers under the direction of a Board of Directors consisting of twelve members. It has fifty-nine offices in Paris and suburbs, and 245 branches in France and foreign countries.

It carries on the following business:

Deposit accounts opened payable on demand or at fixed dates.

Current accounts.

Certificates of deposit issued.

Bills taken for discount or collection.

Payments and transfer of funds effected on all parts of the world.

Foreign exchange bought and sold.

Stock Exchange orders executed.

Securities received for safekeeping.

Coupons and matured bonds collected, all operations in connection with securities such as subscription to new issues, exchanges, transfers, etc., carefully attended to.

Safe deposit boxes for rent.

Commercial credits opened in France and abroad; documents collected.

Surety bonds and similar guaranties furnished.

Suggested Readings on Chapter XV.

Conant, C. A.—History of Modern Banks of Issue.

Andreades, A.—History of the Bank of England.

Withers, H., etc.—The English Banking System.

Liesse, A.—Evolution of Credit and Banks in France.

Reisser, J.—The German Great Banks and Their Concentration.

National Monetary Commission—Interviews on the Banking and Currency Systems of England, Scotland, France, Germany, etc.

Questions and Problems on Chapter XV.

1. What is the effect on the capital of a bank, of an inflation of legal-tender currency?
2. Make a table showing the proportion of the banks' assets absorbed by the Government at different dates.
3. Why should foreign business abroad be more important than foreign business in the United States? Our foreign business is increasing. Will it ever be as large a percentage of our total, as the foreign business of other nations is of their total?
4. Which is cause and which effect: London's vast foreign trade or London's financial power?
5. Why do European countries have big banks with branches while we have independent banks? Is it climate? Race? Political institutions? Social institutions? Size of country?
6. What are the advantages or disadvantages in combining commercial and investment banking?
7. Explain the steps by which inflation took place in Europe.
8. What is the limit to the issue of notes in England? In France? In Germany?
9. What is the difference between a current account and a deposit account? Which classes in the community use each?
10. What causes bank amalgamation?

CHAPTER XVI.

THE CANADIAN BANKING SYSTEM.

1. Organization.

There are 17 large banks with branches all over Canada.

2. Capital.

The minimum capitalization is \$500,000.

3. Supervision.

Reports are made to the Government, but no examinations are made by the Government.

4. Note issues.

There is no specific security. Notes are secured by :

- a. First lien on the assets.
- b. Stockholders' liability.
- c. A safety fund contributed to by all the banks.
- d. A provision which states that notes of failed banks shall bear 5 per cent interest until paid.

Notes have proved to be safe and elastic. The ordinary limit of note issue is the capital of the bank. Banks may have an emergency issue of 15 per cent of the capital and surplus and may issue as many notes as is desired against the deposit of gold or legal tender in the central gold reserve.

5. Credit management.

The borrower ordinarily deals with only one bank. The laws are favorable to the banks in regard to security.

6. Shareholders' audit.

Outside auditors must make an examination at least once a year and report to the shareholders.

7. Scope of business.

The banks carry on, not only commercial business, but also savings and trust and, to some extent, investment banking.

Materials on Chapter XVI.

Selections from Joseph French Johnson's "The Canadian Banking System" (1910), pp. 18-38.

A chartered bank in Canada is a bank of branches, not a bank with branches. The parent bank, technically known as the "head office," neither takes deposits nor lends money. All the banking business is done by the branches, each enjoying considerable independence, but all subject to the supervision and control of the head office. The law places no restrictions upon the number or location of branches. Canadian banks, therefore, have branches in foreign countries as well as in Canada.

The general bank act, under the terms of which every bank obtains and holds its charter, is subject to revision every ten years. In its present form it is substantially as passed in 1890. A few unimportant changes were made in 1900, and among both bankers and politicians there is some talk to-day about the modifications of the act that will be proposed in 1910. The bankers themselves would be well satisfied if the present law were re-enacted without amendment.

Process of Incorporation.

The provisions of the bank act with respect to the organization of new banks are intended to guard against the entry of unfit or inexperienced persons into the banking business. The minimum required capital of a bank is \$500,000, of which all must be subscribed and one-half paid in before a new bank can open. At least five men of integrity and good financial standing must agree to act as provisional directors and secure a favorable report on their project from the parliamentary committee on banking and commerce. These men must agree to subscribe for fairly large blocks of stock, otherwise the committee will be inclined to reject their application. They must convince the committee that their project is a well-considered one, that there is need for the new bank, that it is a *bona-fide* enterprise, that they have in mind a competent man for general manager, that they really intend and expect to do a legitimate banking business. If they satisfy the parliamentary committee it will be granted. The bank, however, cannot yet begin business. Provisional directors now have merely the right to advertise and cause stock books to be opened. If inside of one year capital stock to the amount of \$500,000 has been subscribed and \$250,000 thereof paid in, the provisional directors may call a meeting of the shareholders, at which a board of regular directors shall be chosen. Before this meeting is held at least \$250,000 in cash must be paid over to the minister of

finance. The regular directors must then apply to a body known as the treasury board¹ for a certificate permitting the bank to issue notes² and begin business and the treasury board may refuse this certificate unless it is entirely satisfied that all the requirements of the law have been met. Delay on the part of the treasury board might prove fatal to the new enterprise, for if a new bank does not obtain a certificate within one year from the date of its incorporation, all the rights, powers, and privileges conferred by the act of incorporation cease.

These requirements make it impossible to organize a new bank in Canada with any degree of secrecy. When application is made for a new charter the fact is known to every banker in the Dominion. The secretary of the Canadian Bankers' Association, although not required to do so by law, would undoubtedly get together at once all possible information with regard to the proposed incorporators and the board of provisional directors.

Having obtained its charter, a new bank must open its head office in the place designated, and may then proceed to establish branches or agencies, upon the number and location of which the law places no restriction. Under its charter it has authority to do a general banking business; it may discount commercial paper, lend money on collateral security, accept deposits payable on demand or after notice, and issue circulating notes up to the amount of its unimpaired paid-up capital in denominations of \$5 and multiples thereof. An amendment of the bank act passed July 20, 1908, gives the bank the right to issue what may be called an emergency circulation during the crop-moving season (October 1st to January 31st). During this period the legal maximum of the circulation of a bank is its paid-up capital plus 15 per cent of its combined paid-up capital and surplus or rest fund. This emergency circulation, which consists of notes in form and in other respects exactly like the regular issues, is subject to a tax at a rate not to exceed 5 per cent per annum, the rate being fixed by the governor in council. If a bank's circulation does not exceed its paid-up capital, it pays no tax.

Security and Redemption of Notes.

The law is silent on several subjects that seem of great importance to most bankers in the United States. For instance, it does not require

¹ The treasury board consists of the minister of finance and five ministers nominated from time to time by the governor in council. The minister of finance is chairman of the board and the deputy minister of finance *ex officio* the secretary.

² The designing and engraving of the notes is left with the bank itself. Many of the banks have had their notes made in the United States, but a bank-note company has been established in Canada and is getting a larger proportion of this business every year. The notes must bear the signatures of two officers of the bank. The authority to sign, however, may be delegated to subordinates. When notes are shipped by the head office to a branch they are usually sent with one signature, the other being supplied by one of the branch offices. If the notes should be lost or stolen en route they are worthless.

that the banks shall deposit with a government official, or in any way set aside any kind of security for the protection of the note holder. It does not even require that the banks shall carry a cash reserve against either notes or deposits, nor does the law make the notes a legal tender for any payment. A bank need not accept the notes of other banks. The government does not guarantee the redemption of the notes. Neither does it bind itself to receive them in payment of dues to itself.

Nevertheless the notes of the Canadian banks are everywhere acceptable at par, the people apparently not being at all concerned about their "goodness." And their confidence in the note has been well justified, for nobody since 1890 has lost a dollar through the failure of a bank to redeem its notes. Following are the legal requirements, which for twenty years have proved adequate protection for the note holder:

1. Every bank must redeem its notes at its head office and in such commercial centers as are designated by the treasury board. The redemption cities are the same for all the banks. They are Toronto, Montreal, Halifax, Winnipeg, Victoria, St. John, and Charlottetown.

2. Each bank must keep on deposit with the minister of finance a sum of lawful money (gold or Dominion notes) equal to 5 per cent of its average circulation; the total so deposited is called the "circulation redemption fund." It is a guaranty or insurance fund for use, if need be, in the redemption of the notes of failed banks.

3. Bank notes possess first lien upon the assets of a bank.

4. Bank stockholders are liable to an assessment equal to the par value of their stock.

5. A bank must make to the minister of finance on or before the fifteenth of each month a detailed statement of its assets and liabilities on the last business day of the preceding month. This monthly return, the form for which is set forth in the act, must be signed by three general officers.

6. The Canadian Bankers' Association, an incorporated body of which each bank is a member, is given supervision by the bank act of the issue and cancellation of notes and of the affairs of a failed bank.

7. The notes of a failed bank draw interest at 5 per cent from the date fixed for their redemption by the minister of finance, who may redeem them out of the assets of the bank or out of the "circulation redemption fund."

Importance of Redemption.

Each of these provisions of the law has its value and significance, but only the first is absolutely essential to the successful operation of the system. All the other provisions might be changed or abolished with-

out impairment of the efficiency of the banking system. But the abolishment of this redemption system would at once give Canada a new banking system. The bank note is almost the sole circulating medium in Canada, and the people have confidence in it because it is tested every day at the clearing houses and proves itself as good as gold. This daily test would probably not take place with the same regularity as now if the banks did not have branches or if they were obliged to deposit security against their issues. Canadian banks are national, not local institutions. All but a few of them have branches in every part of the Dominion, and these branches, as fast as they receive the notes of other banks, either send them in to the nearest redemption center or convert them into lawful money—or its equivalent, a bill of exchange—through branches of the issuing banks located in the same towns. The twenty-nine¹ chartered banks have 2,200 branches and each bank is seeking, through its branches, to satisfy all the legitimate needs of the people for a circulating medium. When the note of a bank is in circulation it is earning money for the bank, but when it is in the vault or on the counter of the bank it is an idle and useless piece of paper. Hence every bank always pays out its own notes through its branches and sends the notes of other banks in for redemption, thus increasing its own circulation and strengthening its own reserve.

Furthermore, if the banks were not allowed complete freedom of issue within the prescribed limit, but were required to deposit some form of security, as is required of the national banks in the United States, an investment or speculative risk would arise that would inevitably cause friction. If bonds were designated as security, bankers might often be tempted by high prices to sell their bonds and forgo the profit on circulation for the sake of making a larger profit by the sale of the security. Thus the volume of bank notes might contract even at a time when the people needed more currency. In such case, of course, Canada would be obliged to import gold in order to fill the gap in the circulating medium.

The Circulation Redemption Fund.

The 5 per cent insurance fund for the redemption of the notes of failed banks is theoretically an important and prominent part of the system, yet practically it would seem to be of little consequence, for not once since 1890 has it been necessary to use a dollar of the fund. Banks have failed, to be sure, but the notes of these banks have always been redeemed either out of the assets or by recourse to the double liability of the shareholders. It is a mistake to suppose that the people

¹ There are only 17 banks at present. [Ed.]

of Canada have confidence in bank notes because of the existence of this redemption fund. The average business man knows nothing about the fund and if his attention were called to it as being a source of security for the bank notes he would probably think a 5 per cent reserve altogether too small. The real reason why the people have faith in bank notes is because the notes are always honored by the banks and never fail to stand the test of the clearing house. In other words, they believe that bank notes are good for about the same reason that they believe the sun will rise in the east every twenty-four hours and do not bother themselves about reasons.

Nevertheless this redemption fund does contribute to the strength of the banking system. It makes each bank to a certain extent liable for the mistakes of other banks, and as a result gives rise to a spirit of mutual watchfulness and helpfulness. Other features of the system contribute to the same result, especially the fact that a Canadian bank accepts from a depositor without indorsement the notes of other banks. Since the banks have branches in agricultural and mining communities, often distant from the railroad by several days' journey, and these branches are accepting the notes of other banks and giving credit for them as if they were gold itself, it is evidently important that each banker should have all possible information with regard to the status and business of his competitors. As a result one finds among the bankers of Canada a surprisingly intimate knowledge of each other's affairs.

Two Negative Qualities.

The two negative qualities of the Canadian bank note—its lack of a legal-tender quality and of a government guaranty—at first sight may seem to readers in the United States a source of weakness. Yet Canadian bankers would doubtless all agree that nothing would be gained by making bank notes legal tender for any kind of payment or by making the government in any measure liable for their ultimate redemption. Such measures would probably be rejected as likely to prove harmful. It would be like hampering a flying machine with unnecessary bars of steel. Bank notes, like bank checks, are mere promises to pay money and are more convenient than money because they can be created as need for a medium of exchange arises. When either has done the work that called it into existence, it should disappear from circulation and be redeemed. If it is made a legal tender like money itself, or if its redemption is guaranteed by a strong government, there is always the danger that ignorant classes of people will regard it as money itself and withdraw it from circulation.

The Canadian Government has nothing to do with the daily redemption of bank notes and does not guarantee that they shall be redeemed. It is custodian of the 5 per cent redemption fund and is under obligation to redeem the notes of failed banks out of this fund, but if a series of bank failures should exhaust it the note holder has no guaranty that Government funds will be used for his relief.¹

The possession by the note holder of a first lien upon the assets of a bank, including the funds that may be collected from shareholders on account of their double liability, gives rise to such general confidence in the ultimate convertibility of a bank note that the notes of a failed bank, on account of the interest they bear, sometimes command a premium. As a rule, the notes of such a bank are collected by the other banks and held until the date of redemption has been named by the minister of finance.

Management of Failed Banks.

If a Canadian bank fails to meet any of its liabilities as they accrue, it forfeits at once its right of independent management and is taken charge of by a "curator" appointed by the Canadian Bankers' Association. His powers and duties are defined thus in the law:

"The curator shall assume supervision of the affairs of the bank, and all necessary arrangements for the payment of notes of the bank issued for circulation then outstanding and in circulation shall be made under his supervision; and generally he shall have all powers and shall take all steps and do all things necessary or expedient to protect the rights and interests of the creditors and shareholders of the bank, and to conserve and insure the proper disposition according to law of the assets of the bank, and for the purpose aforesaid he shall have full and free access to all books, accounts, documents, and papers of the bank; and the curator shall continue to supervise the affairs of the bank until he is removed from office, or until the bank resumes business, or until a liquidator is duly appointed to wind up the business of the bank."

If the curator within ninety days is able to restore the solvency of the bank so that it is able to resume payments, it may resume business; otherwise the bank may be "wound up" and its charter revoked. During the first three months of a bank's suspension the stockholders have a chance to raise funds and restore the bank to solvency. If they fail, the curator then gives place to an official called a liquidator, who is appointed by the courts. Under a curator the stockholders still have hope and opportunity; under the liquidator the creditors of the bank are in the saddle.

¹ Bank act, section 65: (6) Nothing herein contained shall be construed to impose any liability upon the government of Canada, or upon the minister, beyond the amount available from time to time out of the circulation fund.

The liquidator must first of all attend to the notes in circulation, their lien upon the assets being prior to all others. Inasmuch as the notes bear interest at 5 per cent from the date of suspension, the other banks are perfectly willing to hold them in their vaults until such a date as the liquidator names for their final redemption, all feeling certain that the notes will sooner or later be paid, for if the assets of the failed bank should prove inadequate, the mutual guaranty fund in the possession of the Government will be drawn upon.

Next to the notes the deposits of the Dominion Government have a prior lien, and then the deposits of provincial governments. If the assets of the bank are not sufficient to satisfy all the claims, the stockholders are liable to an assessment equal in amount to the amount of capital stock to which they subscribed plus any portion thereof which has not been paid up.¹ Thus if a stockholder has subscribed for fifty shares of stock, par value \$100, and has paid in only \$2,500, he is liable to an assessment of \$7,500, of which \$2,500 is on account of the unpaid subscription and \$5,000 is on account of the double liability.²

Monthly Returns to the Government.

The law provides for no publicity with regard to bank affairs beyond the returns to the minister of finance. . . . The minister of finance may call for supplementary information or "special returns from any bank whenever in his judgment they are necessary to afford a full and complete knowledge of its condition." The law, however, gives him no right of examination, and the Government maintains no inspecting force.

In addition to the monthly returns, each must make report once a year as to its dividends, drafts, and bills of exchange that have remained unpaid for five years, and the names and residences of its shareholders. This information, as well as the monthly returns, is given to Parliament and the public.

Canadian Bankers' Association.

The Canadian Bankers' Association is an incorporated body with powers and duties prescribed in an amendment to the bank act passed in 1900. Each chartered bank is represented in the membership and has one vote. The association is required by law to supervise the issue of bank notes and to report to the Government all overissues, to look after

¹ Section 89 of the bank act: "In the event of the property and assets of the bank being insufficient to pay its debts and liabilities, each shareholder of the bank shall be liable for the deficiency to an amount equal to the par value of the shares held by him in addition to any amount not paid up on such shares."

² As a matter of fact in the case of most Canadian banks the paid-up capital stock is equal to the capital subscribed. For instance, the returns to the government for February, 1909, give the following totals: Capital subscribed, \$98,294,381; capital paid up, \$96,160,555.

the destruction of worn and mutilated notes, and to take charge of suspended banks. Its headquarters are in Montreal in the Bank of Montreal building, and its active executive officer is the secretary-treasurer. The expenses of the association are apportioned among the banks and do not apparently constitute a very heavy burden, for the secretary has an exceedingly small staff. All expenses incurred by the association on account of a suspended bank are, of course, a charge against the assets of the bank.

When the notes of a bank are so worn or mutilated that it wishes to replace them with new notes, notice is sent to the secretary of the association, a date is fixed, and in the presence of the secretary the old notes are duly counted and taken to a furnace,¹ where they are consumed in the presence of the secretary and other witnesses. After this solemn operation has been performed and the signatures of all parties observing it have been duly attested, new notes are issued by the association to replace those that have been destroyed.

The clearing houses in the Dominion are subject to regulation by the association. It also has the power to establish subsections and to do educational work by providing for lectures, competitive papers, examinations, etc. The *Journal of the Canadian Bankers' Association*, a monthly publication of excellent quality, is edited by the secretary and is at present the only educational force at work among bank employees.

The Management.

The keynote of the organization of a Canadian bank is the centralization of responsibility. One man, the general manager, is supreme. Above him in authority under the law are the directors, representing the stockholders. Below him is an army of employees, of whom all but two or three owe their position entirely to his favor.

The general managers of Canadian banks are, without exception, men who have been in the banking business since boyhood. They have worked their way up through all the grades of employment by the force of brains, industry, character, and good health. They know from experience the task of every employee and they know when it is well done. They hold their positions because they have proved their fitness. They are, in other words, professional bankers. Untrained outsiders cannot break into the banking business as they do in the United States.

The president of a Canadian bank is merely the chairman of the board of directors. This body holds meetings at least once a week. At these meetings the general manager reports on the business of the week

¹ Each bank maintains one such furnace for this purpose. A wire netting over the chimney prevents the draft from carrying any portions of the consumed notes into the air.

and presents such applications for new credit as seem to require the approval of the board. As a rule, the general manager gives to the directors, either orally or in typewritten form, full information with regard to all the operations of the bank. His recommendations as to the granting of credits are usually approved without much discussion, yet in Canada it is expected of every bank director that he shall give close and personal attention to the bank's operations as reported by the general manager and promptly raise objection whenever in his judgment a mistake is being made. All extensions of credit are reported by the general manager and must be formally approved by the board. Members of the board cannot personally investigate individual cases, and are therefore obliged to place great reliance upon the judgment of the general manager. Nevertheless it is expected of each director that he shall always be well informed as to the important operations of the bank, as to its general policy, as to the amount of its cash reserve, the nature of its investments, etc.

The directors are not forced to rely entirely on the general manager. An officer called the "chief accountant" is expected to know quite as much about the bank's affairs as the general manager himself, and is often present at the board meetings. If the general manager misrepresents any transaction, or fails to reveal to the board the true condition of the bank, the accountant is expected to correct him. In some of the larger banks the board of directors has deemed it wise to place in the head office still another man to represent them, having full power to acquaint himself with the details of all transactions. This man is usually given some routine duties to perform, yet his prime function in the head office is a representative of the board of directors. The appointment of such a man does not imply any lack of confidence in the general manager, but is justified rather by the belief that the general manager, with two good advisers, will be less liable to an aberration of judgment than if he has only one.

The other general or "chief" officers, with headquarters in the "head office," are the superintendent of branches, the inspector, and the secretary. The superintendent is the general manager's right-hand man and is usually in very close touch with his chief and in sympathy with his general policy. The superintendents of the larger banks have the assistance of deputy and department superintendents.

The inspector is at the head of the bank's system of examination. He and his assistants visit the branches at irregular intervals, counting the cash and examining the discounts and other assets. As a rule they are keen to find something to condemn or criticize, and branch managers and their subordinates seem to regard them with considerable fear and

respect. Canadian banks are not subject to government inspection, and bankers maintain that no inspection by an outsider could be as thorough or salutary as that which results from the present system. The expenses of the inspecting staff of some of the larger banks amount to \$80,000 a year.

Theoretically the board of directors is superior to the general manager and can bring him to a halt if he enters upon any policy of which they disapprove. In practice, however, the general manager of a Canadian bank knows so much more about the banking business than any one or all of the directors combined that if a conflict of opinion does arise between the board and himself, the chances are that he will dominate. Yet in most of the banks it would be very difficult for the general manager from improper motives to hold long to a detrimental policy. Even though the accountant did not report against him, the directors, the moment their suspicions were aroused, would call into consultation the managers of some of the larger branches and other experienced officers in whose judgment they had confidence. The entire system of management is so correlated that it is practically impossible for one man to be the bank. Some of the smaller institutions are doubtless dominated by single individuals, but as a rule a Canadian bank has connected with it in responsible positions, all having access to the board of directors, so many men of long experience in the banking business that no one man, however high his position, can use the institution to gratify personal ambition or cupidity.

Management of Branches.

The responsible head of a branch is called the manager. He is selected by the general manager and must conduct his branch in harmony with the views of his chief. His duties are analogous to those of a bank president in the United States. His chief assistant, called the accountant, has charge of all the details, and in the manager's absence is the ranking officer in the branch. He is responsible to the manager and is expected to keep fully informed as to the manager's policy in all its details and to be familiar with all correspondence that passes between the manager and the general manager. He is, in fact, the manager's understudy. In the United States the duties of the so-called Canadian bank accountant are assumed in the smaller banks by the cashier, and in the larger banks are divided between the vice-president and the cashier.

A large branch is in daily communication either by wire or letter with the general manager. The head office allots to each a certain quantity of the bank's notes, a certain amount of "legals," as the Dominion notes

are called, and a certain credit balance in New York and London and other foreign cities. A limit is also placed upon the amount which a branch may loan without consultation with the head office. This limit, of course, varies with the different branches, according to the magnitude of their business.¹ In some respects each branch is treated as an independent institution. For example, a man having an account in one branch of an institution cannot draw checks on another branch. His checks upon the branch with which he has an account, if presented at the counters of other branches of the same bank, will be treated as if they were checks upon some other institution, exchange being charged. A customer, however, can easily arrange to have his account transferred from one branch to another of the same bank.

Managers of branches are required to make weekly returns to the head office of all loans and discounts. They are required to make quarterly reports of profits earned. Every six months they credit earnings to head office. At the end of every month they must submit a balance sheet, a detailed statement of current accounts and liabilities, and a description of all collateral security which they hold. Every quarter they report the amount of profits earned, and twice a year they credit earnings to "head office."

The manager of a branch is allowed, as a rule, to select the members of his staff, but this privilege gives him little patronage, for custom prescribes that vacancies shall be filled by promotion. Boys are engaged as "junior" at about the age of 14 and are paid a salary of \$150 or \$200 a year. Rarely does a bank take into its service a youth who is over 16 years of age, or a man who has been trained up in another bank. Practically no university men are in the banking business. Bankers believe that the best results are obtained by taking on boys at 15 or 16 and training them up through the various subordinate positions, gradually increasing their salaries and adding to their responsibilities. When a boy applies for a position in a bank he is given an application blank containing nearly a hundred questions with regard to his parents, schooling, favorite studies, use of tobacco and intoxicants, attendance at church, his present salary and employment if he is at work, etc., and is required to give the names of at least three or more persons,

¹ "Our branch managers," said a Montreal banker, "have the authority to make loans up to a certain size on their own responsibility. Then each Province has its own supervisor or inspector. In case there is an application for a loan too large for the branch manager to pass on, he makes his recommendation and sends it on to his district supervisor. Up to a certain figure these supervisors have authority to grant loans. If the size of the loan comes within this figure and the branch manager's recommendation is O. K., and it has the approval of his best judgment, the supervisor will grant the loan. With us he can loan up to \$10,000 on his own judgment, backed by the branch manager's. If the loan is for a greater amount than this, the supervisor makes his recommendation and forwards the application with his and the branch manager's opinion to the head office. The head office usually follows the advice of the supervisor and branch manager. If this should come at a time when it is necessary to restrict loans, we can refuse these big loans or have the customer get along with less."

reputable householders, who have known him for five years. If he is hired, he must then take an oath of secrecy, solemnly binding himself not to reveal to any person any information whatever with regard to the operations of the bank.

These precautions in the employment of juniors are deemed necessary because the bank expects during the coming generations to select its branch managers and general managers from these juniors. After a boy is admitted to a bank he is expected not only to do his work well, but also to conduct himself in the community in an orderly and becoming fashion. If he contracts bad habits, gets into debt, or keeps fast company, he is likely to lose his place in the bank, and he must beware of too early marriage, for his general manager will disapprove if he marries on a salary of less than \$1,000. This means that the average bank clerk in Canada cannot marry much before the age of 25. The managers of the banks want the members of their staffs to be well dressed and well fed. Marriage on a small salary, they fear, would give their clerks a worried aspect detrimental to the interests of the bank.

Employees are obliged to furnish a bond, which may be supplied either by private persons or by a guaranty company. Some of the banks have formed mutual guaranty funds, to which all employees, from the general manager down, make regular contribution. The bank itself usually contributes at the outset a sum of money out of profits as a nucleus for the fund. Employees are allowed interest on the money they contribute to the fund, and the entire contribution is returned to the employee when he retires from the service of the bank.

Some of the larger banks have instituted pension schemes for the benefit of employees, the directors setting aside each year a certain percentage of the profits for this purpose and deducting from each employee's salary a certain percentage. The mutual insurance plan has been found more economical than the older methods, and the pension scheme is said to be exerting a most beneficent effect upon the morale of the bank's staff.

Chartered Banks of Canada.
From the Federal Reserve Bulletin, vol. 8, p. 370 (March, 1922).

[From official monthly returns of the chartered banks, supplement to the Canada Gazette.]

	Dec. 31, 1913.	Dec. 31, 1914.	Dec. 31, 1915.	Dec. 31, 1916.	Dec. 31, 1917.	Dec. 31, 1918.	Dec. 31, 1919.	Dec. 31, 1920.	Dec. 31/ 1921.
ASSETS.									
Gold and silver in vault.....	27,945	38,746	42,653	44,506	55,349	60,928	62,553	62,582	59,651
Gold held abroad.....	19,178	23,324	25,413	26,666	26,684	18,388	17,535	20,106	19,209
Domestic notes.....	101,778	138,056	145,546	124,750	167,569	175,745	172,964	177,459	195,731
Deposits of the Minister of Finance for se- curity of note circulation.....	6,561	6,733	6,775	6,700	5,770	5,558	5,947	6,302	6,529
Deposits in central gold reserve.....	17,907	9,700	17,800	43,700	97,270	130,900	125,800	113,353	68,433
Notes of other banks.....	11,777	13,063	15,103	19,702	24,079	31,379	35,138	53,502	50,880
Cheques on other banks.....	60,859	48,991	63,869	76,836	95,589	116,359	145,524	149,970	163,315
Loans and discounts.....	188,062	955,449	968,081	1,009,341	1,088,020	1,323,018	1,559,777	1,669,562	1,594,969
Due from banks and bankers in Canada and other parts of the Dominion.....	14,137	17,901	43,792	32,063	30,357	19,705	24,787	30,771	19,027
Due from banks and bankers elsewhere.....	25,691	33,427	74,144	55,449	51,356	43,221	69,794	82,327	62,324
Government, municipal, and other public securities.....	33,240	33,005	55,727	198,071	412,797	400,453	405,020	311,662	323,642
Railway and other stocks and bonds.....	71,108	72,056	66,769	64,108	55,609	53,138	54,958	46,495	44,021
Call and short loans outside of Canada.....	115,983	85,013	137,158	173,578	134,483	150,243	172,232	211,443	169,859
Overdue debts.....	1,518	6,188	6,632	5,761	4,859	4,543	4,528	6,636	8,444
Bank premises, other real estate, and mort- gages.....	45,475	51,893	54,450	57,018	58,860	60,238	64,046	67,364	77,318
Liabilities of customers under letters of credit.....	8,556	12,248	9,126	9,131	21,981	33,670	51,138	43,751	22,985
Sundry assets.....	4,426	6,667	5,617	4,604	2,571	2,042	3,583	3,664	4,324
Total.....	1,551,255	1,555,560	1,737,996	1,948,045	2,323,163	2,689,833	2,967,374	3,056,979	2,746,733
LIABILITIES.									
Capital paid in.....	114,809	113,917	113,988	113,346	111,674	109,492	119,199	125,067	128,317
Reserve.....	112,118	113,071	112,457	112,383	114,101	116,016	124,713	133,049	128,073
Notes in circulation.....	11,610	105,970	122,200	148,765	192,924	224,501	232,487	228,769	181,003
Due to Dominion and Provincial Govern- ments.....	32,309	41,554	47,117	43,009	82,781	269,684	243,960	137,989	150,161
Other deposits.....	1,108,971	1,111,641	1,279,330	1,467,076	1,740,199	1,876,353	2,116,822	2,307,275	2,052,471
Due to banks and bankers in Canada and in the United Kingdom.....	27,643	24,628	22,364	12,729	13,667	14,502	18,956	17,471	18,407
Due to banks and bankers elsewhere.....	8,217	7,916	10,800	17,595	19,842	23,794	33,913	29,218	30,236
Gifts payable.....	15,517	7,961	3,850	5,242	3,480	3,917	6,381	10,415	11,167
Acceptances under letters of credit.....	8,554	12,248	9,071	8,131	21,981	33,670	51,138	43,751	22,985
Sundry liabilities.....	3,545	2,729	4,351	4,551	6,861	4,830	3,069	3,481	2,319
Total.....	1,551,255	1,314,647	1,499,283	1,706,948	2,051,735	2,448,231	2,706,716	2,778,309	2,472,350

¹ Exclusive of capital, surplus, and undivided profits.

Suggested Readings on Chapter XVI.

Johnson, J. F.—The Canadian Banking System.

Breckinridge, R. M.—History of Banking in Canada.

Questions and Problems on Chapter XVI.

1. Figure the reserves held by the chartered banks against deposit and note liabilities.
2. Contrast the Canadian bank notes with respect to security and elasticity with national bank notes; with Federal reserve notes.
3. In what way is the organization of the Canadian banks similar to the Federal reserve system?
4. Does a high minimum capital insure prudent management?
5. Why are Canadian bank notes redeemed so quickly?
6. What feature of the note issue causes the banks to watch each other?
7. What responsibility does the Government take for Canadian bank notes?
8. What is the difference between a "curator" and a "liquidator"?
9. Of what value are reports if the Government does not examine the banks?
10. What public functions has the Canadian Bankers' Association? Contrast its activities with those of the American Bankers' Association.
11. Outline the organization of a Canadian bank.
12. How is efficiency secured in the branches?
13. How do the accountants' duties in Canada differ from those in the United States.
14. Would the manager of a branch be able to serve the community better, or less satisfactorily, than would the head of a small independent bank in the United States?

CHAPTER XVII.

THE FEDERAL RESERVE SYSTEM.

The Aim of the System.

1. To co-ordinate the activities of the banks of the country.

Organization.

1. The Federal Reserve Board has general control of the system.

It is composed of eight members. The Comptroller of the Currency and the Secretary of the Treasury are *ex-officio* members. In addition, there are six members appointed by the President, with the advice and consent of the Senate. These serve for a term of ten years at a salary of \$12,000. The Secretary of the Treasury is chairman of the board. The governor is appointed by the President, and he is the active executive officer. The President also appoints a vice-governor.

2. Federal reserve banks.

These consist of twelve corporate bodies with Federal charters which unify the banks of their district. The capital is furnished by member banks, who subscribe 6 per cent of their capital and surplus. One-half is paid in. The banks are controlled by nine directors:

Three Class A, elected by member banks to represent banks.

Three Class B, elected by member banks to represent commerce, agriculture, and the public.

Three Class C, selected by the Federal Reserve Board to represent it and the Government.

Earnings are disposed of as follows: A 6 per cent cumulative dividend is paid on paid-in capital; the balance of the earnings goes to "surplus" until it is 100 per cent of the subscribed capital. After surplus has reached that amount, 10 per cent of earnings above dividends goes to "super-surplus," and 90 per cent to the Government as a franchise tax.

3. Branches of Federal reserve banks.

The Federal Reserve Board can permit or require the Federal reserve banks to establish branches conducted by from three to seven directors. A majority of one is appointed by the Federal reserve banks. The remaining directors are appointed by the Federal Reserve Board.

4. Member banks.

National banks *must* belong, while banks with State charters *may* belong if:

- a. They are well managed and have adequate capital.
- b. They agree not to lend on, or to purchase, their own stock, or to impair their capital stock, or to pay unearned dividends.
- c. They become subject to examinations ordered by the Federal Reserve Board or the Federal reserve banks.

State banks may withdraw:

- a. By giving six months' notice.
- b. By surrendering their capital stock.

5. Federal advisory council.

This is composed of one member from each district, elected by the board of directors of the Federal reserve bank of the district.

Powers of the Various Bodies.

1. The Federal Reserve Board can employ necessary attorneys, experts, assistants, clerks, etc., and approve of charters for foreign banking corporations.

a. Over Federal reserve banks, the Federal Reserve Board has wide power:

- (1) It can examine them.
- (2) It can require reports from them.
- (3) It can require one bank to rediscount for another, and set the rate.
- (4) It can suspend reserve requirements.
- (5) It can regulate note issues.
- (6) It can suspend or remove officers.
- (7) It can require the writing off of worthless assets.
- (8) It can suspend, liquidate, or re-organize banks.

- (9) It exercises general supervision.
 - (10) It defines paper eligible for rediscount.
 - (11) It approves discount rates.
 - (12) It acts as a clearing house.
 - (13) It can require them to buy 2 per cent bonds from member banks.
- b. Over member banks the power of the Federal Reserve Board is rather limited:
- (1) It can examine them.
 - (2) It can require reports from them.
 - (3) It determines the reserve requirements by classifying cities as reserve or central reserve cities.
 - (4) It can permit them to exercise trust powers.
 - (5) It can permit them to accept bills of exchange up to 100 per cent of their capital and surplus.
 - (6) It can permit banks with a capital and surplus of over \$1,000,000 to establish foreign branches or invest 10 per cent of their capital and surplus in United States corporations for foreign banking.
 - (7) It can permit any bank to invest in a given United States bank for foreign banking, 5 per cent of its capital and surplus, but not over 10 per cent in all such investments.
2. Powers of the Federal reserve banks.
- a. In general.
- (1) They can receive deposits of the United States Government.
 - (2) They can receive deposits from non-member banks for purposes of collection.
 - (3) They can set discount rates which may be graduated.
 - (4) They can have foreign correspondents.
 - (5) They can issue Federal reserve notes and Federal reserve bank notes.
 - (6) They can conduct a check-collection system.
 - (7) They can act as fiscal agents for the United States Government.

- b. In connection with member banks.
 - (1) They can receive deposits.
 - (2) They can rediscount notes, drafts, and bills of exchange used for agricultural, industrial, or commercial purposes, and paper used for carrying United States bonds and notes. Agricultural paper may run for six months; all other paper may run for 90 days.
 - (3) They can rediscount acceptances with a maturity of not more than three months.
 - (4) They can make advances on notes of member banks for 15 days with eligible paper as collateral.
 - (5) They can act as a clearing house.
- c. Open market transactions.
 - (1) They can deal in gold coin and bullion.
 - (2) They can deal in foreign exchange.
 - (3) They can deal in United States Government bonds and State and local tax warrants.
 - (4) They can deal in foreign and domestic bills of exchange.
- 3. New powers given to the national banks.
 - a. They can accept bills of exchange.
 - b. They can exercise trust powers.
 - c. They can loan on real estate.
 - d. In small places they can act as insurance agents.

Outstanding Activities of the System.

- 1. It aided in financing the war by taking charge of the sale of Government bonds and short-time obligations, by loaning to purchasers of these securities, and by making short-time loans to the Government.
- 2. It provides safe and elastic currency.
 - a. Federal reserve notes—secured by at least 40 per cent in gold, and enough commercial paper to make at least 100 per cent.

b. Federal reserve bank notes—secured by United States bonds or certificates of indebtedness.

3. It mobilizes reserves.

Member banks' reserves are held in the Federal reserve banks. The percentages required are as follows:

	<i>Deposits.</i>	
	<i>Demand.</i>	<i>Time.</i>
Central reserve city banks	13%	3%
Reserve city banks	10%	3%
Country banks	7%	3%

The Federal reserve bank holds reserves as follows:

Against Federal reserve notes	40%	in gold
Against deposits	35%	in gold
		or lawful money

Member banks needing funds can rediscount with their Federal reserve bank; one reserve bank needing funds can rediscount with another. Thus, the reserve can be utilized where needed.

4. It provides a means for check collection and the transfer of funds.

The Federal reserve system is trying to bring about a universal par check-collecting system. Each bank acts as a clearing house for its district. The Federal Reserve Board manages a gold settlement fund in Washington, by which the indebtedness of one reserve bank to another is settled and transfers of funds from one part of the country to another are made.

State Banks' Objections to Joining the Federal Reserve System.

1. Membership subjects them to double examinations and reports.
2. They have little paper eligible for rediscount.
3. They fear the loss of exchange charges.
4. They lose some privileges.

Materials on Chapter XVII.**Federal Reserve Act.**

[Approved December 23, 1913.]

As amended August 4, 1914 (38 Stat., 682, Chap. 225); August 15, 1914 (38 Stat., 961, Chap. 252); March 3, 1915 (38 Stat., 958, Chap. 93); September 7, 1916 (39 Stat., 752, Chap. 461); June 21, 1917 (40 Stat., 232, Chap. 32); September 26, 1918; March 3, 1919; September 17, 1919; December 24, 1919; April 13, 1920; February 27, 1921; June 14, 1921, June 3, 1922; July 1, 1922.

An Act To provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the short title of this Act shall be the "Federal Reserve Act."

Wherever the word "bank" is used in this Act, the word shall be held to include State bank, banking association, and trust company, except where national banks or Federal reserve banks are specifically referred to.

The terms "national bank" and "national banking association" used in this Act shall be held to be synonymous and interchangeable. The term "member bank" shall be held to mean any national bank, State bank, or bank or trust company which has become a member of one of the reserve banks created by this Act. The term "board" shall be held to mean Federal Reserve Board; the term "district" shall be held to mean Federal reserve district; the term "reserve bank" shall be held to mean Federal reserve bank.

Federal Reserve Districts.

Sec. 2. As soon as practicable, the Secretary of the Treasury, the Secretary of Agriculture and the Comptroller of the Currency, acting as "The Reserve Bank Organization Committee," shall designate not less than eight nor more than twelve cities to be known as Federal reserve cities, and shall divide the continental United States, excluding Alaska, into districts, each district to contain only one of such Federal reserve cities. The determination of said organization committee shall not be subject to review except by the Federal Reserve Board when organized: *Provided*, That the districts shall be apportioned with due

regard to the convenience and customary course of business and shall not necessarily be coterminous with any State or States. The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board, not to exceed twelve in all. Such districts shall be known as Federal reserve districts and may be designated by number. A majority of the organization committee shall constitute a quorum with authority to act.

Said organization committee shall be authorized to employ counsel and expert aid, to take testimony, to send for persons and papers, to administer oaths, and to make such investigation as may be deemed necessary by the said committee in determining the reserve districts and in designating the cities within such district where such Federal reserve banks shall be severally located. The said committee shall supervise the organization in each of the cities designated of a Federal reserve bank, which shall include in its title the name of the city in which it is situated, as "Federal Reserve Bank of Chicago."

Under regulations to be prescribed by the organization committee, every national banking association in the United States is hereby required, and every eligible bank in the United States and every trust company within the District of Columbia, is hereby authorized to signify in writing, within sixty days after the passage of this Act, its acceptance of the terms and provisions hereof. When the organization committee shall have designated the cities in which Federal reserve banks are to be organized, and fixed the geographical limits of the Federal reserve districts, every national banking association within that district shall be required within thirty days after notice from the organization committee, to subscribe to the capital stock of such Federal reserve bank in a sum equal to six per centum of the paid-up capital stock and surplus of such bank, one-sixth of the subscription to be payable on call of the organization committee or of the Federal Reserve Board, one-sixth within three months and one-sixth within six months thereafter, and the remainder of the subscription, or any part thereof, shall be subject to call when deemed necessary by the Federal Reserve Board, said payments to be in gold or gold certificates.

The shareholders of every Federal reserve bank shall be held individually responsible, equally and ratably, and not one for another, for all contracts, debts, and engagements of such bank to the extent of the amount of their subscriptions to such stock at the par value thereof in addition to the amount subscribed, whether such subscriptions have been paid up in whole or in part, under the provisions of this Act.

Any national bank failing to signify its acceptance of the terms of this Act within the sixty days aforesaid, shall cease to act as a reserve

agent, upon thirty days' notice, to be given within the discretion of the said organization committee or of the Federal Reserve Board.

Should any national banking association in the United States now organized fail within one year after the passage of this Act to become a member bank or fail to comply with any of the provisions of this Act applicable thereto, all of the rights, privileges, and franchises of such association granted to it under the national bank act, or under the provisions of this Act, shall be thereby forfeited. Any non-compliance with or violation of this Act shall, however, be determined and adjudged by any court of the United States of competent jurisdiction in a suit brought for that purpose in the district or territory in which such bank is located, under direction of the Federal Reserve Board, by the Comptroller of the Currency in his own name before the association shall be declared dissolved. In cases of such non-compliance or violation, other than the failure to become a member bank under the provisions of this Act, every director who participated in or assented to the same shall be held liable in his personal or individual capacity for all damages which said bank, its shareholders, or any other person shall have sustained in consequence of such violation.

Such dissolution shall not take away or impair any remedy against such corporation, its stockholders or officers, for any liability or penalty which shall have been previously incurred.

Should the subscriptions by banks to the stock of said Federal reserve banks or any one or more of them be, in the judgment of the organization committee, insufficient to provide the amount of capital required therefor, then and in that event the said organization committee may, under conditions and regulations to be prescribed by it, offer to public subscription at par such an amount of stock in said Federal reserve banks, or any one or more of them, as said committee shall determine, subject to the same conditions as to payment and stock liability as provided for member banks.

No individual, copartnership, or corporation other than a member bank of its district shall be permitted to subscribe for or to hold at any time more than \$25,000 par value of stock in any Federal reserve bank. Such stock shall be known as public stock and may be transferred on the books of the Federal reserve bank by the chairman of the board of directors of such bank.

Should the total subscriptions by banks and the public to the stock of said Federal reserve banks, or any one or more of them, be, in the judgment of the organization committee, insufficient to provide the amount of capital required therefor, then and in that event the said organization committee shall allot to the United States such an amount

of said stock as said committee shall determine. Said United States stock shall be paid for at par out of any money in the Treasury not otherwise appropriated, and shall be held by the Secretary of the Treasury and disposed of for the benefit of the United States in such manner, at such times, and at such price, not less than par, as the Secretary of the Treasury shall determine.

Stock not held by member banks shall not be entitled to voting power.

The Federal Reserve Board is hereby empowered to adopt and promulgate rules and regulations governing the transfers of said stock.

No Federal reserve bank shall commence business with a subscribed capital less than \$4,000,000. The organization of reserve districts and Federal reserve cities shall not be construed as changing the present status of reserve cities and central reserve cities, except in so far as this Act changes the amount of reserves that may be carried with approved reserve agents located therein. The organization committee shall have power to appoint such assistants and incur such expenses in carrying out the provisions of this Act as it shall deem necessary, and such expenses shall be payable by the Treasurer of the United States upon voucher approved by the Secretary of the Treasury, and the sum of \$100,000, or so much thereof as may be necessary, is hereby appropriated, out of any moneys in the Treasury not otherwise appropriated, for the payment of such expenses.

Branch Offices.

[As amended by act approved June 21, 1917 (40 Stat., 232, chap. 32.)]

Sec. 3. The Federal Reserve Board may permit or require any Federal reserve bank to establish branch banks within the Federal reserve district in which it is located or within the district of any Federal bank which may have been suspended. Such branches, subject to such rules and regulations as the Federal Reserve Board may prescribe, shall be operated under the supervision of a board of directors to consist of not more than seven nor less than three directors, of whom a majority of one shall be appointed by the Federal reserve bank of the district, and the remaining directors by the Federal Reserve Board. Directors of branch banks shall hold office during the pleasure of the Federal Reserve Board.

Federal Reserve Banks.

[As amended by act approved June 21, 1917 (40 Stat., 232, Chap. 32); act approved September 26, 1918.]

Sec. 4. When the organization committee shall have established Federal reserve districts as provided in section two of this Act, a certifi-

cate shall be filed with the Comptroller of the Currency showing the geographical limits of such districts and the Federal reserve city designated in each of such districts. The Comptroller of the Currency shall thereupon cause to be forwarded to each national bank located in each district, and to such other banks declared to be eligible by the organization committee which may apply therefor, an application blank in form to be approved by the organization committee, which blank shall contain a resolution to be adopted by the board of directors of each bank executing such application, authorizing a subscription to the capital stock of the Federal reserve bank organizing in that district in accordance with the provisions of this Act.

When the minimum amount of capital stock prescribed by this Act for the organization of any Federal reserve bank shall have been subscribed and allotted, the organization committee shall designate any five banks of those whose applications have been received, to execute a certificate of organization, and thereupon the banks so designated shall, under their seals, make an organization certificate which shall specifically state the name of such Federal reserve bank, the territorial extent of the district over which the operations of such Federal reserve bank are to be carried on, the city and State in which said bank is to be located, the amount of capital stock and the number of shares into which the same is divided, the name and place of doing business of each bank executing such certificate, and of all banks which have subscribed to the capital stock of such Federal reserve bank and the number of shares subscribed to the capital stock of such Federal reserve bank and the number of shares subscribed by each, and the fact that the certificate is made to enable those banks executing same, and all banks which have subscribed or may thereafter subscribe to the capital stock of such Federal reserve bank, to avail themselves of the advantages of this Act.

The said organization certificate shall be acknowledged before a judge of some court of record or notary public; and shall be, together with the acknowledgment thereof, authenticated by the seal of such court, or notary, transmitted to the Comptroller of the Currency, who shall file, record and carefully preserve the same in his office.

Upon the filing of such certificate with the Comptroller of the Currency as aforesaid, the said Federal reserve bank shall become a body corporate, and as such, and in the name designated in such organization certificate, shall have power—

First. To adopt and use a corporate seal.

Second. To have succession for a period of twenty years from its organization unless it is sooner dissolved by an Act of Congress, or unless its franchise becomes forfeited by some violation of law.

Third. To make contracts.

Fourth. To sue and be sued, complain and defend, in any court of law or equity.

Fifth. To appoint by its board of directors such officers and employees as are not otherwise provided for in this Act, to define their duties, require bonds of them and fix the penalty thereof, and to dismiss at pleasure such officers or employees.

Sixth. To prescribe by its board of directors, by-laws not inconsistent with law, regulating the manner in which its general business may be conducted, and the privileges granted to it by law may be exercised and enjoyed.

Seventh. To exercise by its board of directors, or duly authorized officers or agents, all powers specifically granted by the provisions of this Act and such incidental powers as shall be necessary to carry on the business of banking within the limitations prescribed by this Act.

Eighth.¹ Upon deposit with the Treasurer of the United States of any bonds of the United States in the manner provided by existing law relating to national banks, to receive from the Comptroller of the Currency circulating notes in blank, registered and countersigned as provided by law, equal in amount to the par value of the bonds so deposited, such notes to be issued under the same conditions and provisions of law as relate to the issue of circulating notes of national banks secured by bonds of the United States bearing the circulating privilege, except that the issue of such notes shall not be limited to the capital stock of such Federal reserve bank.

But no Federal reserve bank shall transact any business except such as is incidental and necessarily preliminary to its organization until it has been authorized by the Comptroller of the Currency to commence business under the provisions of this Act.

Every Federal reserve bank shall be conducted under the supervision and control of a board of directors.

The board of directors shall perform the duties usually appertaining to the office of directors of banking associations and all such duties as are prescribed by law.

Said board shall administer the affairs of said bank fairly and impartially and without discrimination in favor of or against any member bank or banks and shall, subject to the provisions of law and the orders of the Federal Reserve Board, extend to each member bank such discounts, advancements and accommodations as may be safely and reason-

¹ See section 18. Also sec. 5 of Pittman Act, authorizing issuance of Federal Reserve Bank notes in any denominations (including \$1 and \$2) against security of United States certificates of indebtedness, or of United States one-year gold notes.

ably made with due regard for the claims and demands of other member banks.

Such board of directors shall be selected as hereinafter specified and shall consist of nine members, holding office for three years, and divided into three classes, designated as classes A, B, and C.

Class A shall consist of three members, who shall be chosen by and be representative of the stock-holding banks.

Class B shall consist of three members, who at the time of their election shall be actively engaged in their district in commerce, agriculture or some other industrial pursuit.

Class C shall consist of three members who shall be designated by the Federal Reserve Board. When the necessary subscriptions to the capital stock have been obtained for the organization of any Federal reserve bank, the Federal Reserve Board shall appoint the class C directors and shall designate one of such directors as chairman of the board to be selected. Pending the designation of such chairman, the organization committee shall exercise the powers and duties appertaining to the office of chairman in the organization of such Federal reserve bank.

No Senator or Representative in Congress shall be a member of the Federal Reserve Board or an officer or a director of a Federal reserve bank.

No director of class B shall be an officer, director, or employee of any bank.

No director of class C shall be an officer, director, employee, or stockholder of any bank.

Directors of class A and class B shall be chosen in the following manner:

The Federal Reserve Board shall classify the member banks of the district into three general groups or divisions, designating each group by number. Each group shall consist as nearly as may be of banks of similar capitalization. Each member bank shall be permitted to nominate to the chairman of the board of directors of the Federal reserve bank of the district one candidate for director of class A and one candidate for director of class B. The candidates so nominated shall be listed by the chairman, indicating by whom nominated, and a copy of said list shall, within fifteen days after its completion, be furnished by the chairman to each member bank. Each member bank by a resolution of the board or by an amendment to its by-laws shall authorize its president, cashier, or some other officer to cast the vote of the member bank in the elections of class A and class B directors.

Within fifteen days after receipt of the list of candidates the duly authorized officer of a member bank shall certify to the chairman his first,

second, and other choices for director of class A and class B, respectively, upon a preferential ballot upon a form furnished by the chairman of the board of directors of the Federal reserve bank of the district. Each such officer shall make a cross opposite the name of the first, second, and other choices for a director of class A and for a director of class B, but shall not vote more than one choice for any one candidate. No officer or director of a member bank shall be eligible to serve as a class A director unless nominated and elected by banks which are members of the same group as the member bank of which he is an officer or director.

Any person who is an officer or director of more than one member bank shall not be eligible for nomination as a class A director except by banks in the same group as the bank having the largest aggregate resources of any of those of which such person is an officer or director.

Any candidate having a majority of all votes cast in the column of first choice shall be declared elected. If no candidate have a majority of all the votes in the first column, then there shall be added together the votes cast by the electors for such candidates in the second column and the votes cast for the several candidates in the first column. If any candidate then have a majority of the electors voting, by adding together the first and second choices, he shall be declared elected. If no candidate have a majority of electors voting when the first and second choices shall have been added, then the votes cast in the third column for other choices shall be added together in like manner, and the candidate then having the highest number of votes shall be declared elected. An immediate report of election shall be declared.

Class C directors shall be appointed by the Federal Reserve Board. They shall have been for at least two years residents of the district for which they are appointed, one of whom shall be designated by said board as chairman of the board of directors of the Federal reserve bank and as "Federal reserve agent." He shall be a person of tested banking experience, and in addition to his duties as chairman of the board of directors of the Federal reserve bank he shall be required to maintain, under regulations to be established by the Federal Reserve Board, a local office of said board on the premises of the Federal reserve bank. He shall make regular reports to the Federal Reserve Board and shall act as its official representative for the performance of the functions conferred upon it by this act. He shall receive an annual compensation to be fixed by the Federal Reserve Board and paid monthly by the Federal reserve bank to which he is designated. One of the directors of class C shall be appointed by the Federal Reserve Board as deputy chairman to exercise the powers of the chairman of the board when necessary. In

case of the absence of the chairman and deputy chairman, the third-class C director shall preside at meetings of the board.

Subject to the approval of the Federal Reserve Board the Federal reserve agent shall appoint one or more assistants. Such assistants, who shall be persons of tested banking experience, shall assist the Federal reserve agent in the performance of his duties and shall also have power to act in his name and stead during his absence or disability. The Federal Reserve Board shall require such bonds of the assistant Federal reserve agents as it may deem necessary for the protection of the United States. Assistants to the Federal reserve agent shall receive an annual compensation, to be fixed and paid in the same manner as that of the Federal reserve agent.

Directors of Federal reserve banks shall receive, in addition to any compensation otherwise provided, a reasonable allowance for necessary expenses in attending meetings of their respective boards, which amount shall be paid by the respective Federal reserve banks. Any compensation that may be provided by boards of directors of Federal reserve banks for directors, officers or employees shall be subject to the approval of the Federal Reserve Board.

The Reserve Bank Organization Committee may, in organizing Federal reserve banks, call such meetings of bank directors in the several districts as may be necessary to carry out the purposes of this Act, and may exercise the functions herein conferred upon the chairman of the board of directors of each Federal reserve bank pending the complete organization of such bank.

At the first meeting of the full board of directors of each Federal reserve bank, its shall be the duty of the directors of classes A, B and C, respectively, to designate one of the members of each class whose term of office shall expire in one year from the first of January nearest to date of such meeting, one whose term of office shall expire at the end of two years from said date, and one whose term of office shall expire at the end of three years from said date. Thereafter every director of a Federal reserve bank chosen as hereinbefore provided shall hold office for a term of three years. Vacancies that may occur in the several classes of directors of Federal reserve banks may be filled in the manner provided for the original selection of such directors, such appointees to hold office for the unexpired terms of their predecessors.

Stock Issues; Increase and Decrease of Capital.

Sec. 5. The capital stock of each Federal reserve bank shall be divided into shares of \$100 each. The outstanding capital stock shall be increased from time to time as member banks increase their capital stock

and surplus or as additional banks become members, and may be decreased as member banks reduce their capital stock or surplus or cease to be members. Shares of the capital stock of Federal reserve banks owned by member banks shall not be transferred or hypothecated. When a member bank increases its capital stock or surplus, it shall thereupon subscribe for an additional amount of capital stock of the Federal reserve bank of its district equal to six per centum of the said increase, one-half of said subscription to be paid in the manner hereinbefore provided for original subscription, and one-half subject to call of the Federal Reserve Board. A bank applying for stock in a Federal reserve bank at any time after the organization thereof must subscribe for an amount of the capital stock of the Federal reserve bank equal to 6 per centum of the paid-up capital stock and surplus of said applicant bank, paying therefor its par value plus one-half of one per centum a month from the period of the last dividend. When the capital stock of any Federal reserve bank shall have been increased either on account of the increase of capital stock of member banks or on account of the increase in the number of member banks, the board of directors shall cause to be executed a certificate to the Comptroller of the Currency showing the increase in capital stock, the amount paid in and by whom paid. When a member bank reduces its capital stock it shall surrender a proportionate amount of its holdings in the capital of said Federal reserve bank, and when a member bank voluntarily liquidates it shall surrender all of its holdings of the capital stock of said Federal reserve bank and be released from its stock subscription not previously called. In either case the shares surrendered shall be canceled and the member bank shall receive in payment therefor, under regulations to be prescribed by the Federal Reserve Board, a sum equal to its cash-paid subscriptions on the shares surrendered and one-half of one per centum a month from the period of the last dividend, not to exceed the book value thereof, less any liability of such member bank to the Federal reserve bank.

Sec. 6. If any member bank shall be declared insolvent and a receiver appointed therefor, the stock held by it in said Federal reserve bank shall be canceled, without impairment of its liability, and all cash-paid subscriptions on said stock, with one-half of one per centum per month from the period of last dividend, not to exceed the book value thereof, shall be first applied to all debts of the insolvent member bank to the Federal reserve bank, and the balance, if any, shall be paid to the receiver of the insolvent bank. Whenever the capital stock of a Federal reserve bank is reduced, either on account of a reduction in capital stock of any member bank or of the liquidation or insolvency of such bank, the board of directors shall cause to be executed a certificate to the Comptroller

of the Currency showing such reduction of capital stock and the amount repaid to such bank.

Division of Earnings.

[As amended by act approved March 3, 1919.]

Sec. 7. After all necessary expenses of a Federal reserve bank have been paid or provided for, the stockholders shall be entitled to receive an annual dividend of 6 per centum on the paid-in capital stock, which dividend shall be cumulative. After the aforesaid dividend claims have been fully met, the net earnings shall be paid to the United States as a franchise tax except that the whole of such net earnings, including those for the year ending December thirty-first, nineteen hundred and eighteen, shall be paid into a surplus fund until it shall amount to one hundred per centum of the subscribed capital stock of such bank, and that thereafter ten per centum of such net earnings shall be paid into the surplus.

The net earnings derived by the United States from Federal reserve banks shall, in the discretion of the Secretary, be used to supplement the gold reserve held against outstanding United States notes, or shall be applied to the reduction of the outstanding bonded indebtedness of the United States under regulations to be prescribed by the Secretary of the Treasury. Should a Federal reserve bank be dissolved or go into liquidation, any surplus remaining, after the payment of all debts, dividend requirements as hereinbefore provided, and the par value of the stock, shall be paid to and become the property of the United States and shall be similarly applied.

Federal reserve banks, including the capital stock and surplus therein, and the income derived therefrom shall be exempt from Federal, State, and local taxation, except taxes upon real estate.

Sec. 8. Section fifty-one hundred and fifty-four, United States Revised Statutes, is hereby amended to read as follows:

Any bank incorporated by special law of any State or of the United States or organized under the general laws of any State or of the United States and having an unimpaired capital sufficient to entitle it to become a national banking association under the provisions of the existing laws may, by the vote of the shareholders owning not less than fifty-one per centum of the capital stock of such bank or banking association, with the approval of the Comptroller of the Currency be converted into a national banking association, with any name approved by the Comptroller of the Currency.

Provided, however, That said conversion shall not be in contravention of the State law. In such case the articles of association and organiza-

tion certificate may be executed by a majority of the directors of the bank or banking institution, and the certificate shall declare that the owners of fifty-one per centum of the capital stock have authorized the directors to make such certificate and to change or convert the bank or banking institution into a national association. A majority of the directors, after executing the articles of association and the organization certificate, shall have power to execute all other papers and to do whatever may be required to make its organization perfect and complete as a national association. The shares of any such bank may continue to be for the same amount each as they were before the conversion, and the directors may continue to be directors of the association until others are elected or appointed in accordance with the provisions of the statutes of the United States. When the Comptroller has given to such bank or banking association a certificate that the provisions of this Act have been complied with, such bank or banking association, and all its stockholders, officers, and employees, shall have the same powers and privileges, and shall be subject to the same duties, liabilities and regulations, in all respects, as shall have been prescribed by the Federal Reserve Act and by the national banking Act for associations originally organized as national banking associations.

State Banks as Members.

[As amended by act approved June 21, 1917 (40 Stat., 232, chap. 32), and act approved July 1, 1922.]

Sec. 9. Any bank incorporated by special law of any State, or organized under the general laws of any State or of the United States, desiring to become a member of the Federal Reserve System, may make application to the Federal Reserve Board, under such rules and regulations as it may prescribe, for the right to subscribe to the stock of the Federal reserve bank organized within the district in which the applying bank is located. Such application shall be for the same amount of stock that the applying bank would be required to subscribe to as a national bank. The Federal Reserve Board, subject to such conditions as it may prescribe, may permit the applying bank to become a stockholder of such Federal reserve bank.

In acting upon such applications the Federal Reserve Board shall consider the financial condition of the applying bank, the general character of its management, and whether or not the corporate powers exercised are consistent with the purposes of this act.

Whenever the Federal Reserve Board shall permit the applying bank

to become a stockholder in the Federal reserve bank of the district its stock subscription shall be payable on call of the Federal Reserve Board, and stock issued to it shall be held subject to the provisions of this act.

All banks admitted to membership under authority of this section shall be required to comply with the reserve and capital requirements of this act and to conform to those provisions of law imposed on national banks which prohibit such banks from lending on or purchasing their own stock, which relate to the withdrawal or impairment of their capital stock, and which relate to the payment of unearned dividends. Such banks and the officers, agents, and employees thereof shall also be subject to the provisions of and to the penalties prescribed by section fifty-two hundred and nine of the Revised Statutes, and shall be required to make reports of condition and of the payment of dividends to the Federal reserve bank of which they become a member. Not less than three of such reports shall be made annually on call of the Federal reserve bank on dates to be fixed by the Federal Reserve Board. Failure to make such reports within ten days after the date they are called for shall subject the offending bank to a penalty of \$100 a day for each day that it fails to transmit such report; such penalty to be collected by the Federal reserve bank by suit or otherwise.

As a condition of membership such banks shall likewise be subject to examinations made by direction of the Federal Reserve Board or of the Federal reserve bank by examiners selected or approved by the Federal Reserve Board.

Whenever the directors of the Federal reserve bank shall approve the examinations made by the State authorities, such examinations and the reports thereof may be accepted in lieu of examinations made by examiners selected or approved by the Federal Reserve Board: *Provided, however,* That when it deems it necessary the board may order special examinations by examiners of its own selection and shall in all cases approve the form of the report. The expenses of all examinations, other than those made by State authorities, shall be assessed against and paid by the banks examined.

If at any time it shall appear to the Federal Reserve Board that a member bank has failed to comply with the provisions of this section or the regulations of the Federal Reserve Board made pursuant thereto, it shall be within the power of the board after hearing to require such bank to surrender its stock in the Federal reserve bank and to forfeit all rights and privileges of membership. The Federal Reserve Board may restore membership upon due proof of compliance with the conditions imposed by this section.

Any State bank or trust company desiring to withdraw from member-

ship in a Federal Reserve bank may do so, after six months' written notice shall have been filed with the Federal Reserve Board, upon the surrender and cancellation of all its holdings of capital stock in the Federal reserve bank: *Provided, however,* That no Federal reserve bank shall, except under express authority of the Federal Reserve Board, cancel within the same calendar year more than twenty-five per centum of its capital stock for the purpose of effecting voluntary withdrawals during that year. All such applications shall be dealt with in the order in which they are filed with the board. Whenever a member shall surrender its stock holdings in a Federal reserve bank, or shall be ordered to do so by the Federal Reserve Board, under authority of law, all of its rights and privileges as a member bank shall thereupon cease and determine, and after due provision has been made for any indebtedness due or to become due to the Federal reserve bank it shall be entitled to a refund of its cash-paid subscription with interest at the rate of one-half of one per centum per month from date of last dividend, if earned, the amount refunded in no event to exceed the book value of the stock at that time, and shall likewise be entitled to repayment of deposits and of any other balance due from the Federal reserve bank.

No applying bank shall be admitted to membership in a Federal reserve bank unless it possesses a paid-up, unimpaired capital sufficient to entitle it to become a national banking association in the place where it is situated under the provisions of the national-bank act.

Banks becoming members of the Federal Reserve System under authority of this section shall be subject to the provisions of this section and to those of this act which relate specifically to member banks, but shall not be subject to examination under the provisions of the first two paragraphs of section fifty-two hundred and forty of the Revised Statutes as amended by section twenty-one of this act.¹ Subject to the provisions of this act and to the regulations of the board made pursuant thereto, any bank becoming a member of the Federal Reserve System shall retain its full charter and statutory rights as a State bank or trust company, and may continue to exercise all corporate powers granted it by the State in which it was created, and shall be entitled to all privileges of member banks:

"Provided, however, That no Federal reserve bank shall be permitted to discount for any State bank or trust company notes, drafts, or bills of exchange of any borrower who is liable for borrowed money to such State bank or trust company in an amount greater than that which could be borrowed lawfully from such State bank or trust company were it a national banking association."

¹ Amending section 21 of this act.

The Federal reserve bank, as a condition of the discount of notes, drafts, and bills of exchange for such State bank or trust company, shall require a certificate or guaranty to the effect that the borrower is not liable to such bank in excess of the amount provided by this section, and will not be permitted to become liable in excess of this amount while such notes, drafts, or bills of exchange are under discount with the Federal reserve bank.

It shall be unlawful for any officer, clerk, or agent of any bank admitted to membership under authority of this section to certify any check drawn upon such bank unless the person or company drawing the check has on deposit therewith at the time such check is certified an amount of money equal to the amount specified in such check. Any check so certified by duly authorized officers shall be a good and valid obligation against such bank, but the act of any such officer, clerk, or agent in violation of this section may subject such bank to a forfeiture of its membership in the Federal Reserve System upon hearing by the Federal Reserve Board.¹

Federal Reserve Board.

[As amended by act approved June 3, 1922.]

Sec. 10. A Federal Reserve Board is hereby created which shall consist of eight members, including the Secretary of the Treasury and the Comptroller of the Currency, who shall be members *ex officio*, and six members appointed by the President of the United States, by and with the advice and consent of the Senate. In selecting the six appointive members of the Federal Reserve Board, not more than one of whom shall be selected from any one Federal reserve district, the President shall have due regard to a fair representation of the financial, agricultural, industrial and commercial interests, and geographical divisions of the country. The six members of the Federal Reserve Board appointed by the President and confirmed as aforesaid shall devote their entire time to the business of the Federal Reserve Board and shall each receive an annual salary of \$12,000, payable monthly, together with actual necessary traveling expenses, and the Comptroller of the Currency, as *ex officio* member of the Federal Reserve Board, shall, in addition to the salary now paid him as Comptroller of the Currency, receive the sum of \$7,000 annually for his services as a member of said board.

The Secretary of the Treasury and the Comptroller of the Currency shall be ineligible during the time they are in office and for two years thereafter to hold any office, position, or employment in any member

¹ See section 5208, Revised Statutes, as amended by act of September 26, 1918, for penalty for false certification of checks by officers of Federal Reserve Banks and national banks.

bank. The appointive members of the Federal Reserve Board shall be ineligible during the time they are in office and for two years thereafter to hold any office, position, or employment in any member bank, except that this restriction shall not apply to a member who has served the full term for which he was appointed. Of the six members thus appointed by the President one shall be designated by the President to serve for two, one for four, one for six, one for eight and the balance of the members for ten years, and thereafter each member so appointed shall serve for a term of ten years, unless sooner removed for cause by the President. Of the six persons thus appointed, one shall be designated by the President as governor and one as vice-governor of the Federal Reserve Board. The governor of the Federal Reserve Board, subject to its supervision, shall be the active executive officer. The Secretary of the Treasury may assign offices in the Department of the Treasury for the use of the Federal Reserve Board. Each member of the Federal Reserve Board shall within fifteen days after notice of appointment make and subscribe to the oath of office.

The Federal Reserve Board shall have power to levy semiannually upon the Federal reserve banks, in proportion to their capital stock and surplus, an assessment sufficient to pay its estimated expenses and the salaries of its members and employees for the half year succeeding the levying of such assessment, together with any deficit carried forward from the preceding half year.

The first meeting of the Federal Reserve Board shall be held in Washington, District of Columbia, as soon as may be after the passage of this Act, at a date to be fixed by the Reserve Bank Organization Committee. The Secretary of the Treasury shall be *ex officio* chairman of the Federal Reserve Board. No member of the Federal Reserve Board shall be an officer or director of any bank, banking institution, trust company, or Federal reserve bank nor hold stock in any bank, banking institution, or trust company; and before entering upon his duties as a member of the Federal Reserve Board he shall certify under oath to the Secretary of the Treasury that he has complied with this requirement. Whenever a vacancy shall occur, other than by expiration of term, among the six members of the Federal Reserve Board appointed by the President, as above provided, a successor shall be appointed by the President, with the advice and consent of the Senate, to fill such vacancy, and when appointed he shall hold office for the unexpired term of the member whose place he is selected to fill.

The President shall have power to fill all vacancies that may happen on the Federal Reserve Board during the recess of the Senate by granting commissions which shall expire with the next session of the Senate.

Nothing in this Act contained shall be construed as taking away any powers heretofore vested by law in the Secretary of the Treasury which relate to the supervision, management, and control of the Treasury Department and bureaus under such department, and wherever any power vested by this Act in the Federal Reserve Board or the Federal reserve agent appears to conflict with the powers of the Secretary of the Treasury, such powers shall be exercised subject to the supervision and control of the Secretary.

The Federal Reserve Board shall annually make a full report of its operations to the Speaker of the House of Representatives, who shall cause the same to be printed for the information of the Congress.

Section three hundred and twenty-four of the Revised Statutes of the United States shall be amended so as to read as follows:

"Sec. 324. There shall be in the Department of the Treasury a bureau charged with the execution of all laws passed by Congress relating to the issue and regulation of national currency secured by United States bonds and, under the general supervision of the Federal Reserve Board, of all Federal Reserve notes, the chief officer of which bureau shall be called the Comptroller of the Currency and shall perform his duties under the general directions of the Secretary of the Treasury.

"No Federal reserve bank shall have authority hereafter to enter into any contract or contracts for the erection of any building of any kind or character, or to authorize the erection of any building, in excess of \$250,000, without the consent of Congress having previously been given therefor in express terms: *Provided*, That nothing herein shall apply to any building now under construction."

[As amended by act approved Sept. 7, 1916 (39 Stat., 752, chap. 461);
act approved Sept. 26, 1918; act approved Mar. 3, 1919;
and act approved Feb. 27, 1921.]

Sec. 11. The Federal Reserve Board shall be authorized and empowered:

(a) To examine at its discretion the accounts, books and affairs of each Federal reserve bank and of each member bank and to require such statements and reports as it may deem necessary. The said board shall publish once each week a statement showing the condition of each Federal reserve bank and a consolidated statement for all Federal reserve banks. Such statements shall show in detail the assets and liabilities of the Federal reserve banks, single and combined, and shall furnish full information regarding the character of the money held as reserve and the amount, nature and maturities of the paper and other investments owned or held by Federal reserve banks.

(b) To permit, or, on the affirmative vote of at least five members of the Reserve Board to require Federal reserve banks to rediscount the discounted paper of other Federal reserve banks at rates of interest to be fixed by the Federal Reserve Board.

(c) To suspend for a period not exceeding thirty days, and from time to time to renew such suspension for periods not exceeding fifteen days, any reserve requirements specified in this Act: *Provided*, That it shall establish a graduated tax upon the amounts by which the reserve requirements of this Act may be permitted to fall below the level hereinafter specified: *And provided further*, That when the gold reserve held against Federal reserve notes falls below forty per centum, the Federal Reserve Board shall establish a graduated tax of not more than one per centum per annum upon such deficiency until the reserves fall to thirty-two and one-half per centum, and when said reserve falls below thirty-two and one-half per centum, a tax at the rate increasingly of not less than one and one-half per centum per annum upon each two and one-half per centum or fraction thereof that such reserve falls below thirty-two and one-half per centum. The tax shall be paid by the reserve bank, but the reserve bank shall add an amount equal to said tax to the rates of interest and discount fixed by the Federal Reserve Board.

(d) To supervise and regulate through the bureau under the charge of the Comptroller of the Currency the issue and retirement of Federal reserve notes, and to prescribe rules and regulations under which such notes may be delivered by the Comptroller to the Federal reserve agents applying therefor.

(e) To add to the number of cities classified as reserve and central reserve cities under existing law in which national banking associations are subject to the reserve requirements set forth in section twenty of this Act; or to reclassify existing reserve and central reserve cities or to terminate their designation as such.

(f) To suspend or remove any officer or director of any Federal reserve bank, the cause of such removal to be forthwith communicated in writing by the Federal Reserve Board to the removed officer or director and to said bank.

(g) To require the writing off of doubtful or worthless assets upon the books and balance sheets of Federal reserve banks.

(h) To suspend, for the violation of any of the provisions of this Act, the operations of any Federal reserve bank, to take possession thereof, administer the same during the period of suspension, and, when deemed advisable, to liquidate or reorganize such bank.

(i) To require bonds of Federal reserve agents, to make regulations for the safeguarding of all collateral, bonds, Federal reserve notes,

money or property of any kind deposited in the hands of such agents, and said board shall perform the duties, functions, or services specified in this Act, and make all rules and regulations necessary to enable said board effectively to perform the same.

(j) To exercise general supervision over said Federal reserve banks.

(k) To grant by special permit to national banks applying therefor, when not in contravention of State or local law, the right to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the State in which the national bank is located.

Whenever the laws of such State authorize or permit the exercise of any or all of the foregoing powers by State banks, trust companies, or other corporations which compete with national banks, the granting to and the exercise of such powers by national banks shall not be deemed to be in contravention of State or local law within the meaning of this Act.

National banks exercising any or all of the powers enumerated in this subsection shall segregate all assets held in any fiduciary capacity from the general assets of the bank and shall keep a separate set of books and records showing in proper detail all transactions engaged in under authority of this subsection. Such books and records shall be open to inspection by the State authorities to the same extent as the books and records of corporations organized under State law which exercise fiduciary powers, but nothing in this Act shall be construed as authorizing the State authorities to examine the books, records, and assets of the national bank which are not held in trust under authority of this subsection.

No national bank shall receive in its trust department deposits of current funds subject to check or the deposit of checks, drafts, bills of exchange, or other items for collection or exchange purposes. Funds deposited or held in trust by the bank awaiting investment shall be carried in a separate account and shall not be used by the bank in the conduct of its business unless it shall first set aside in the trust department United States bonds or other securities approved by the Federal Reserve Board.

In the event of the failure of such bank the owners of the funds held in trust for investment shall have a lien on the bonds or other securities so set apart in addition to their claim against the estate of the bank.

Whenever the laws of a State require corporations acting in a fiduciary capacity to deposit securities with the State authorities for the protec-

tion of private or court trusts, national banks so acting shall be required to make similar deposits and securities so deposited shall be held for the protection of private or court trusts, as provided by the State law.

National banks in such cases shall not be required to execute the bond usually required of individuals if State corporations under similar circumstances are exempt from this requirement.

National banks shall have power to execute such bond when so required by the laws of the State.

In any case in which the laws of a State require that a corporation acting as trustee, executor, administrator, or in any capacity specified in this section, shall take an oath or make an affidavit, the president, vice president, cashier, or trust officer of such national bank may take the necessary oath or execute the necessary affidavit.

It shall be unlawful for any national banking association to lend any officer, director, or employee any funds held in trust under the powers conferred by this section. Any officer, director, or employee making such loan, or to whom such loan is made, may be fined not more than \$5,000, or imprisoned not more than five years, or may be both fined and imprisoned, in the discretion of the court.

In passing upon applications for permission to exercise the powers enumerated in this subsection, the Federal Reserve Board may take into consideration the amount of capital and surplus of the applying bank, whether or not such capital and surplus is sufficient under the circumstances of the case, the needs of the community to be served, and any other facts and circumstances that seem to it proper, and may grant or refuse the application accordingly: *Provided*, That no permit shall be issued to any national banking association having a capital and surplus less than the capital and surplus required by State law or State banks, trust companies, and corporations exercising such powers.

(1) To employ such attorneys, experts, assistants, clerks, or other employees as may be deemed necessary to conduct the business of the board. All salaries and fees shall be fixed in advance by said board and shall be paid in the same manner as the salaries of the members of said board. All such attorneys, experts, assistants, clerks, and other employees shall be appointed without regard to the provisions of the Act of January sixteenth, eighteen hundred and eighty-three (volume twenty-two, United States Statutes at Large, page four hundred and three), and amendments thereto, or any rule or regulation made in pursuance thereof: *Provided*, That nothing herein shall prevent the President from placing said employees in the classified service.

(m) Upon the affirmative vote of not less than five of its members,

the Federal Reserve Board shall have power to permit Federal reserve banks to discount for any member bank notes, drafts, or bills of exchange bearing the signature or indorsement of any one borrower in excess of the amount permitted by section 9 and section 13 of this Act, but in no case to exceed 20 per centum of the member bank's capital and surplus: *Provided, however,* That all such notes, drafts, or bills of exchange discounted for any member bank in excess of the amount permitted under such sections shall be secured by not less than a like face amount of bonds or notes of the United States issued since April 24, 1917, for which the borrower shall in good faith prior to January 1, 1921, have paid or agreed to pay not less than the full face amount thereof, or certificates of indebtedness of the United States: *Provided further,* That the provisions of this subsection (*m*) shall not be operative after October 31, 1921.

Federal Advisory Council.

Sec. 12. There is hereby created a Federal Advisory Council, which shall consist of as many members as there are Federal reserve districts. Each Federal reserve bank by its board of directors shall annually select from its own Federal reserve district one member of said council, who shall receive such compensation and allowances as may be fixed by his board of directors subject to the approval of the Federal Reserve Board. The meetings of said advisory council shall be held at Washington, District of Columbia, at least four times each year, and oftener if called by the Federal Reserve Board. The council may in addition to the meetings above provided for hold such other meetings in Washington, District of Columbia, or elsewhere, as it may deem necessary, may select its own officers and adopt its own methods of procedure, and a majority of its members shall constitute a quorum for the transaction of business. Vacancies in the council shall be filled by the respective reserve banks, and members selected to fill vacancies, shall serve for the unexpired term.

The Federal Advisory Council shall have power, by itself or through its officers, (1) to confer directly with the Federal Reserve Board on general business conditions; (2) to make oral or written representations concerning matters within the jurisdiction of said board; (3) to call for information and to make recommendations in regard to discount rates, rediscount business, note issues, reserve conditions in the various districts, the purchase and sale of gold or securities by reserve banks, open-market operations by said banks, and the general affairs of the reserve banking system.

Powers of Federal Reserve Banks.

[As amended by act approved March 3, 1915 (38 Stat., 958, chap. 93); act approved September 7, 1916 (39 Stat., 752, chap. 461); act approved June 21, 1917 (40 Stat., 232, chap. 32.)]

Sec. 13. Any Federal reserve bank may receive from any of its member banks, and from the United States,¹ deposits of current funds in lawful money, national bank notes, Federal reserve notes, or checks, and drafts, payable upon presentation, and also, for collection, maturing notes and bills; or, solely for purposes of exchange or of collection, may receive from other Federal reserve banks deposits of current funds in lawful money, national bank notes, or checks upon other Federal reserve banks, and checks and drafts, payable upon presentation within its district, and maturing notes and bills payable within its district; or, solely for the purposes of exchange or of collection, may receive from any non-member bank or trust company deposits of current funds in lawful money, national-bank notes, Federal reserve notes, checks and drafts payable upon presentation, or maturing notes and bills: *Provided*, Such non-member bank or trust company maintains with the Federal reserve bank of its district a balance sufficient to offset the items in transit held for its account by the Federal reserve bank: *Provided, further*, That nothing in this or any other section of this act shall be construed as prohibiting a member or non-member bank from making reasonable charges, to be determined and regulated by the Federal Reserve Board, but in no case to exceed 10 cents per \$100 or fraction thereof, based on the total of checks and drafts presented at any one time, for collection or payment of checks and drafts and remission therefor by exchange or otherwise; but no such charges shall be made against the Federal reserve banks.

Upon the indorsement of any of its member banks, which shall be deemed a waiver of demand, notice and protest by such bank as to its own indorsement exclusively, any Federal reserve bank may discount notes, drafts, and bills of exchange arising out of actual commercial transactions; that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this act. Nothing in this Act contained shall be construed to prohibit such notes,

¹ Under authority of War Finance Act, approved April 5, 1918, as amended by act of Mar. 3, 1919, may receive deposits from War Finance Corporation.

drafts, and bills of exchange, secured by staple agricultural products, or other goods, wares, or merchandise from being eligible for such discount; but such definition shall not include notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States.¹ Notes, drafts, and bills admitted to discount under the terms of this paragraph must have a maturity at the time of discount of not more than ninety days, exclusive of days of grace: *Provided*, That notes, drafts, and bills drawn or issued for agricultural purposes or based on live stock and having a maturity not exceeding six months, exclusive of days of grace, may be discounted in an amount to be limited to a percentage of the assets of the Federal reserve bank, to be ascertained and fixed by the Federal Reserve Board.

The aggregate of such notes, drafts, and bills bearing the signature or indorsement of any one borrower, whether a person, company, firm, or corporation, rediscounted for any one bank shall at no time exceed ten per centum of the unimpaired capital and surplus of said bank; but this restriction shall not apply to the discount of bills of exchange drawn in good faith against actually existing values.²

Any Federal reserve bank may discount acceptances of the kinds hereinafter described, which have a maturity at the time of discount of not more than three months' sight, exclusive of days of grace, and which are indorsed by at least one member bank.

Any member bank may accept drafts or bills of exchange drawn upon it having not more than six months' sight to run, exclusive of days of grace, which grow out of transactions involving the importation or exportation of goods; or which grow out of transactions involving the domestic shipment of goods provided shipping documents conveying or securing title are attached at the time of acceptance; or which are secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title covering readily marketable staples. No member bank shall accept, whether in a foreign or domestic transaction, for any one person, company, firm, or corporation to an amount equal at any time in the aggregate to more than ten per centum of its paid-up and unimpaired capital stock and surplus, unless the bank is secured either by attached documents or by some other actual security growing out of the same transaction as the acceptance; and no bank shall accept such bills to an amount equal at any time in the aggregate to more than one-half of its paid-up and unimpaired capital stock and

¹ Or bonds of the War Finance Corporation. See act approved April 5, 1918.

² Amended by section 11 (m), as amended March 3, 1919.

surplus: *Provided, however,* That the Federal Reserve Board, under such general regulation as it may prescribe, which shall apply to all banks alike regardless of the amount of capital stock and surplus, may authorize any member bank to accept such bills to an amount not exceeding at any time in the aggregate one hundred per centum of its paid-up and unimpaired capital stock and surplus: *Provided further,* That the aggregate of acceptances growing out of domestic transactions shall in no event exceed fifty per centum of such capital stock and surplus.

Any Federal reserve bank may make advances to its member banks on their promissory notes for a period not exceeding fifteen days at rates to be established by such Federal reserve banks, subject to the review and determination of the Federal Reserve Board, provided such promissory notes are secured by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks under the provisions of this Act, or by the deposit or pledge of bonds or notes of the United States.¹

Section fifty-two hundred and two of the Revised Statutes of the United States is hereby amended so as to read as follows: "No national banking association shall at any time be indebted, or in any way liable, to an amount exceeding the amount of its capital stock at such time actually paid in and remaining undiminished by losses or otherwise, except on account of demands of the nature following:

First. Notes of circulation.

Second. Bills of exchange or drafts drawn against money actually on deposit to the credit of the association, or due thereto.

Third. Bills of exchange or drafts drawn against money actually on deposit to the credit of the association, or due thereto.

Fourth. Liabilities to the stockholders of the association for dividends and reserve profits.

Fifth. Liabilities incurred under the provisions of the Federal Reserve Act.

Sixth. Liabilities incurred under the provisions of the War Finance Corporation Act.

Seventh. Liabilities created by the indorsement of accepted bills of exchange payable abroad actually owned by the indorsing bank and discounted at home or abroad.

The discount and rediscount and the purchase and sale by any Federal reserve bank of any bills receivable and of domestic and foreign bills of exchange, and of acceptances authorized by this Act, shall be subject

¹ Or by bonds of War Finance Corporation. See sec. 13, War Finance Corporation Act, approved April 5, 1918.

to such restrictions, limitations, and regulations as may be imposed by the Federal Reserve Board.

That in addition to the powers now vested by law in national banking associations organized under the laws of the United States any such association located and doing business in any place the population of which does not exceed five thousand inhabitants, as shown by the last preceding decennial census, may, under such rules and regulations as may be prescribed by the Comptroller of the Currency, act as the agent for any fire, life, or other insurance company authorized by the authorities of the State in which said bank is located to do business in said State, by soliciting and selling insurance and collecting premiums on policies issued by such company; and may receive for services so rendered such fees or commissions as may be agreed upon between the said association and the insurance company for which it may act as agent; and may also act as the broker or agent for others in making or procuring loans on real estate located within one hundred miles of the place in which said bank may be located, receiving for such services a reasonable fee or commission; *Provided, however,* That no such bank shall in any case guarantee either the principal or interest of any such loans or assume or guarantee the payment of any premium on insurance policies issued through its agency by its principal: *And provided further,* That the bank shall not guarantee the truth of any statement made by an assured in filing his application for insurance.

Any member bank may accept drafts or bills of exchange drawn upon it having not more than three months' sight to run, exclusive of days of grace, drawn under regulations to be prescribed by the Federal Reserve Board by banks or bankers in foreign countries or dependencies or insular possessions of the United States for the purpose of furnishing dollar exchange as required by the usages of trade in the respective countries, dependencies, or insular possessions. Such drafts or bills may be acquired by Federal reserve banks in such amounts and subject to such regulations, restrictions, and limitations as may be prescribed by the Federal Reserve Board: *Provided, however,* That no member bank shall accept such drafts or bills of exchange referred to in this paragraph for any one bank to an amount exceeding in the aggregate ten per centum of the paid-up and unimpaired capital and surplus of the accepting bank unless the draft or bill of exchange is accompanied by documents conveying or securing title or by some other adequate security: *Provided further,* That no member bank shall accept such drafts or bills in an amount exceeding at any time the aggregate of one-half of its paid-up and unimpaired capital and surplus.

Open-Market Operations.

[As amended by act approved September 7, 1916 (39 Stat., 752, chap. 461); act approved June 21, 1917 (40 Stat., 232, chap. 32); act approved April 13, 1920.]

Sec. 14. Any Federal reserve bank may, under rules and regulations prescribed by the Federal Reserve Board, purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations, or individuals, cable transfers and bankers' acceptances and bills of exchange of the kinds and maturities by this Act made eligible for rediscount, with or without the indorsement of a member bank.

Every Federal reserve bank shall have power:

(a) To deal in gold coin and bullion at home or abroad, to make loans thereon, exchange Federal reserve notes for gold, gold coin, or gold certificates, and to contract for loans of gold coin or bullion, giving therefor, when necessary, acceptable security, including the hypothecation of United States bonds or other securities which Federal reserve banks are authorized to hold;

(b) To buy and sell, at home or abroad, bonds and notes of the United States, and bills, notes, revenue bonds, and warrants with a maturity from date of purchase of not exceeding six months, issued in anticipation of the collection of taxes or in anticipation of the receipt of assured revenues by any State, county, district, political subdivision, or municipality in the continental United States, including irrigation, drainage and reclamation districts, such purchases to be made in accordance with rules and regulations prescribed by the Federal Reserve Board;

(c) To purchase from member banks and to sell, with or without its indorsement, bills of exchange arising out of commercial transactions, as hereinbefore defined;

(d) To establish from time to time, subject to review and determination of the Federal Reserve Board, rates of discount to be charged by the Federal reserve bank for each class of paper, which shall be fixed with a view of accommodating commerce and business and which, subject to the approval, review, and determination of the Federal Reserve Board, may be graduated or progressed on the basis of the amount of the advances and discount accommodations extended by the Federal reserve bank to the borrowing bank.

(e) To establish accounts with other Federal reserve banks for exchange purposes and, with the consent or upon the order and direction of the Federal Reserve Board and under regulations to be prescribed

by said board, to open and maintain accounts in foreign countries, appoint correspondents, and establish agencies in such countries where-soever it may be deemed best for the purpose of purchasing, selling, and collecting bills of exchange, and to buy and sell, with or without its indorsement, through such correspondents or agencies, bills of exchange (or acceptances) arising out of actual commercial transactions which have not more than ninety days to run, exclusive of days of grace, and which bear the signature of two or more responsible parties, and, with the consent of the Federal Reserve Board, to open and maintain banking accounts for such foreign correspondents or agencies. Whenever any such account has been opened or agency or correspondent has been appointed by a Federal reserve bank, with the consent of or under the order and direction of the Federal Reserve Board, any other Federal reserve bank may, with the consent and approval of the Federal Reserve Board, be permitted to carry on or conduct, through the Federal reserve bank opening such account or appointing such agency or correspondent, and transaction authorized by this section under rules and regulations to be prescribed by the board.

Government Deposits.

Sec. 15.¹ The moneys held in the general fund of the Treasury, except the five per centum fund for the redemption of outstanding national-bank notes and the funds provided in this Act for the redemption of Federal reserve notes may, upon the direction of the Secretary of the Treasury, be deposited in Federal reserve banks, which banks, when required by the Secretary of the Treasury, shall act as fiscal agents of the United States,² and the revenues of the Government or any part thereof may be deposited in such banks, and disbursements may be made by checks drawn against such deposits.

No public funds of the Philippine Islands, or of the postal savings, or any Government funds, shall be deposited in the continental United States in any bank not belonging to the system established by this Act:³ *Provided, however,* That nothing in this Act shall be construed to deny the right of the Secretary of the Treasury to use member banks as depositories.

¹ This section in effect amended by Appropriation Act of 1920, approved May 29, 1920.

² Under War Finance Corporation Act, approved April 5, 1918, as amended by Act of March 3, 1919, Federal Reserve Banks may also act as fiscal agents of the War Finance Corporation.

³ Under section 7 of the act approved April 24, 1917, section 8 of the act approved September 24, 1917, and section 8 of the act approved April 4, 1918, the proceeds of sale of Liberty bonds of the first, second, and third issues may be deposited in nonmember banks. The act of May 18, 1916, amending the Postal Savings Act, authorizes the deposit of postal savings funds in non-member banks.

Note Issues.

[As amended by act approved September 7, 1916 (39 Stat., 752, chap. 461); act approved June 21, 1917 (40 Stat., 232, chap. 32). Act approved September 26, 1918.]

Sec. 16. Federal reserve notes, to be issued at the discretion of the Federal Reserve Board for the purpose of making advances to Federal reserve banks through the Federal reserve agents as hereinafter set forth and for no other purpose, are hereby authorized. The said notes shall be obligations of the United States and shall be receivable by all national and member banks and Federal reserve banks and for all taxes, customs, and other public dues. They shall be redeemed in gold on demand at the Treasury Department of the United States, in the city of Washington, District of Columbia, or in gold or lawful money at any Federal reserve bank.

Any Federal reserve bank may make application to the local Federal reserve agent for such amount of the Federal reserve notes hereinbefore provided for as it may require. Such application shall be accompanied with a tender to the local Federal reserve agent of collateral in amount equal to the sum of the Federal reserve notes thus applied for and issued pursuant to such application. The collateral security thus offered shall be notes, drafts, bills of exchange, or acceptances acquired under the provisions of section thirteen of this act, or bills of exchange indorsed by a member bank of any Federal reserve district and purchased under the provisions of section fourteen of this act, or bankers' acceptances purchased under the provisions of said section fourteen, or gold or gold certificates; but in no event shall such collateral security, whether gold, gold certificates, or eligible paper, be less than the amount of Federal reserve notes applied for.¹ The Federal reserve agent shall each day notify the Federal Reserve Board of all issues and withdrawals of Federal reserve notes to and by the Federal reserve bank to which he is accredited. The said Federal Reserve Board may at any time call upon a Federal reserve bank for additional security to protect the Federal reserve notes issued to it.

Every Federal reserve bank shall maintain reserves in gold or lawful money of not less than thirty-five per centum against its deposits and reserves in gold of not less than forty per centum against its Federal reserve notes in actual circulation: *Provided, however,* That when the Federal reserve agent holds gold or gold certificates as collateral for

¹ Under section 13 of War Finance Corporation Act, approved April 5, 1918, notes secured by War Finance Corporation bonds may be used to the same extent, as collateral, as notes secured by United States bonds.

Federal reserve notes issued to the bank such gold or gold certificates shall be counted as part of the gold reserve which such bank is required to maintain against its Federal reserve notes in actual circulation. Notes so paid out shall bear upon their faces a distinctive letter and serial number which shall be assigned by the Federal Reserve Board to each Federal reserve bank. Whenever Federal reserve notes issued through one Federal reserve bank shall be received by another Federal reserve bank, they shall be promptly returned for credit or redemption to the Federal reserve bank through which they were originally issued or, upon direction of such Federal reserve bank, they shall be forwarded direct to the Treasurer of the United States to be retired. No Federal reserve bank shall pay out notes issued through another under penalty of a tax of ten per centum upon the face value of notes so paid out. Notes presented for redemption at the Treasury of the United States shall be paid out of the redemption fund and returned to the Federal reserve banks through which they were originally issued, and thereupon such Federal reserve bank shall, upon demand of the Secretary of the Treasury, reimburse such redemption fund in lawful money or, if such Federal reserve notes have been redeemed by the Treasurer in gold or gold certificates, then such funds shall be reimbursed to the extent deemed necessary by the Secretary of the Treasury in gold or gold certificates, and such Federal reserve bank shall, so long as any of its Federal reserve notes remain outstanding, maintain with the Treasurer in gold an amount sufficient in the judgment of the Secretary to provide for all redemptions to be made by the Treasurer. Federal reserve notes received by the Treasurer otherwise than for redemption may be exchanged for gold out of the redemption fund hereinafter provided and returned to the reserve bank through which they were originally issued, or they may be returned to such bank for the credit of the United States. Federal reserve notes unfit for circulation shall be returned by the Federal reserve agents to the Comptroller of the Currency for cancellation and destruction.

The Federal Reserve Board shall require each Federal reserve bank to maintain on deposit in the Treasury of the United States a sum in gold sufficient in the judgment of the Secretary of the Treasury for the redemption of the Federal reserve notes issued to such bank, but in no event less than five per centum of the total amount of notes issued less the amount of gold or gold certificates held by the Federal reserve agent as collateral security; but such deposit of gold shall be counted and included as part of the forty per centum reserve hereinbefore required. The board shall have the right, acting through the Federal reserve agent, to grant in whole or in part, or to reject entirely the application

of any Federal reserve bank for Federal reserve notes, but to the extent that such application may be granted the Federal Reserve Board shall, through its local Federal reserve agent, supply Federal reserve notes to the banks so applying, and such bank shall be charged with the amount of notes issued to it and shall pay such rate of interest as may be established by the Federal Reserve Board on only that amount of such notes which equals the total amount of its outstanding Federal reserve notes less the amount of gold or gold certificates held by the Federal reserve agent as collateral security. Federal reserve notes issued to any such bank shall, upon delivery, together with such notes of such Federal reserve bank as may be issued under section eighteen of this act upon security of United States two per centum Government bonds, become a first and paramount lien on all the assets of such bank.

Any Federal reserve bank may at any time reduce its liability for outstanding Federal reserve notes by depositing with the Federal reserve agent its Federal reserve notes, gold, gold certificates, or lawful money of the United States. Federal reserve notes so deposited shall not be reissued, except upon compliance with the conditions of an original issue.

The Federal reserve agent shall hold such gold, gold certificates, or lawful money available exclusively for exchange for the outstanding Federal reserve notes when offered by the reserve bank of which he is a director. Upon the request of the Secretary of the Treasury the Federal Reserve Board shall require the Federal reserve agent to transmit to the Treasurer of the United States so much of the gold held by him as collateral security for Federal reserve notes as may be required for the exclusive purpose of the redemption of such Federal reserve notes, but such gold when deposited with the Treasurer shall be counted and considered as if collateral security on deposit with the Federal reserve agent.

Any Federal reserve bank may at its discretion withdraw collateral deposited with the local Federal reserve agent for the protection of its Federal reserve notes issued to it and shall at the same time substitute therefor other collateral of equal amount with the approval of the Federal reserve agent under regulations to be prescribed by the Federal Reserve Board. Any Federal reserve bank may retire any of its Federal reserve notes by depositing them with the Federal reserve agent or with the Treasurer of the United States, and such Federal reserve bank shall thereupon be entitled to receive back the collateral deposited with the Federal reserve agent for the security of such notes. Federal reserve banks shall not be required to maintain the reserve or the redemption fund heretofore provided for against Federal reserve notes which have been retired. Federal reserve notes so deposited shall not be reissued except upon compliance with the conditions of an original issue.

All Federal reserve notes and all gold, gold certificates, and lawful money issued to or deposited with any Federal reserve agent under the provisions of the Federal reserve act shall hereafter be held for such agent, under such rules and regulations as the Federal Reserve Board may prescribe, in the joint custody of himself and the Federal reserve bank to which he is accredited. Such agent and such Federal reserve bank shall be jointly liable for the safekeeping of such Federal reserve notes, gold, gold certificates, and lawful money. Nothing herein contained, however, shall be construed to prohibit a Federal reserve agent from depositing gold or gold certificates with the Federal Reserve Board, to be held by such board subject to his order, or with the Treasurer of the United States for the purposes authorized by law.

In order to furnish suitable notes for circulation as Federal reserve notes, the Comptroller of the Currency shall, under the direction of the Secretary of the Treasury, cause plates and dies to be engraved in the best manner to guard against counterfeits and fraudulent alterations, and shall have printed therefrom and numbered such quantities of such notes of the denominations of \$5, \$10, \$20, \$50, \$100, \$500, \$1000, \$5000, \$10,000 as may be required to supply the Federal reserve banks. Such notes shall be in form and tenor as directed by the Secretary of the Treasury under the provisions of this Act and shall bear the distinctive numbers of the several Federal reserve banks through which they are issued.

When such notes have been prepared, they shall be deposited in the Treasury, or in the subtreasury or mint of the United States nearest the place of business of each Federal reserve bank and shall be held for the use of such bank subject to the order of the Comptroller of the Currency for their delivery, as provided by this Act.

The plates and dies to be procured by the Comptroller of the Currency for the printing of such circulating notes shall remain under his control and direction, and the expenses necessarily incurred in executing the laws relating to the procuring of such notes, and all other expenses incidental to their issue and retirement, shall be paid by the Federal reserve banks, and the Federal Reserve Board shall include in its estimate of expenses levied against the Federal reserve banks a sufficient amount to cover the expenses herein provided for.

The examination of plates, dies, and pieces, and so forth, and regulations relating to such examination of plates, dies, and so forth, of national-bank notes provided for in section fifty-one hundred and seventy-four Revised Statutes, is hereby extended to include notes herein provided for.

Any appropriation heretofore made out of the general funds of the

Treasury for engraving plates and dies, the purchase of distinctive paper, or to cover any other expense in connection with the printing of national-bank notes or notes provided for by the Act of May thirtieth, nineteen hundred and eight, and any distinctive paper that may be on hand at the time of the passage of this Act may be used in the discretion of the Secretary for the purposes of this Act, and should the appropriations heretofore made be insufficient to meet the requirements of this Act in addition to circulating notes provided for by existing law, the Secretary is hereby authorized to use so much of any funds in the Treasury not otherwise appropriated for the purpose of furnishing the notes aforesaid: *Provided, however,* That nothing in this section contained shall be construed as exempting national banks or Federal reserve banks from their liability to reimburse the United States for any expenses incurred in printing and issuing circulating notes.

Every Federal reserve bank shall receive on deposit at par from member banks or from Federal reserve banks checks and drafts drawn upon any of its depositors, and when remitted by a Federal reserve bank, checks and drafts drawn by any depositor in any other Federal reserve bank or member bank upon funds to the credit of said depositor in said reserve bank or member bank. Nothing herein contained shall be construed as prohibiting a member bank from charging its actual expense incurred in collecting and remitting funds, or for exchange sold to its patrons. The Federal Reserve Board shall, by rule, fix the charges to be collected by the member banks from its patrons whose checks are cleared through the Federal reserve bank and the charge which may be imposed for the service of clearing or collection rendered by the Federal reserve bank.

The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds and charges therefor among Federal reserve banks and their branches, and may at its discretion exercise the functions of a clearing house for such Federal reserve banks, or may designate a Federal reserve bank to exercise such functions, and may also require each such bank to exercise the functions of a clearing house for its member banks.

That the Secretary of the Treasury is hereby authorized and directed to receive deposits of gold coin or of gold certificates with the Treasurer or any assistant treasurer of the United States when tendered by any Federal reserve bank or Federal Reserve Board. The Secretary shall prescribe by regulation the form of receipt to be issued by the Treasurer or Assistant Treasurer to the Federal reserve bank or Federal reserve agent making the deposit, and a duplicate of such receipt shall be delivered to the Federal Reserve Board by the Treasurer at Washington

upon proper advices from any assistant treasurer that such deposit has been made. Deposits so made shall be held subject to the orders of the Federal Reserve Board and shall be payable in gold coin or gold certificates on the order of the Federal Reserve Board to any Federal reserve bank or Federal reserve agent at the Treasury or at the Subtreasury of the United States nearest the place of business of such Federal reserve bank or such Federal reserve agent: *Provided, however,* That any expense incurred in shipping gold to or from the Treasury or subtreasuries in order to make such payments, or as a result of making such payments, shall be paid by the Federal Reserve Board and assessed against the Federal reserve banks. The order used by the Federal Reserve Board in making such payments shall be signed by the governor or vice governor, or such other officers or members as the board may by regulation prescribe. The form of such order shall be approved by the Secretary of the Treasury.

The expenses necessarily incurred in carrying out these provisions, including the cost of the certificates or receipts issued for deposits received, and all expenses incident to the handling of such deposits shall be paid by the Federal Reserve Board and included in its assessments against the several Federal reserve banks.

Gold deposits standing to the credit of any Federal reserve bank with the Federal Reserve Board shall, at the option of said bank, be counted as part of the lawful reserve which it is required to maintain against outstanding Federal reserve notes, or as a part of the reserve it is required to maintain against deposits.

Nothing in this section shall be construed as amending section six of the act of March fourteenth, nineteen hundred, as amended by the acts of March fourth, nineteen hundred and seven, March second, nineteen hundred and eleven, and June twelfth, nineteen hundred and sixteen, nor shall the provisions of this section be construed to apply to the deposits made or to the receipts or certificates issued under those acts.

[As amended by act approved June 21, 1917 (40 Stat., 232, chap. 32).]

Sec. 17. So much of the provisions of section fifty-one hundred and fifty-nine of the Revised Statutes of the United States, and section four of the act of June twentieth, eighteen hundred and seventy-four, and section eight of the act of July twelfth, eighteen hundred and eighty-two, and of any other provisions of existing statutes as require that before any national banking association shall be authorized to commence banking business it shall transfer and deliver to the Treasurer of the United States a stated amount of United States registered bonds, and so much of those provisions or of any other provisions of existing

statutes as require any national banking association now or hereafter organized to maintain a minimum deposit of such bonds with the Treasurer is hereby repealed.

Refunding Bonds.

Sec. 18. After two years from the passage of this Act, and at any time during a period of twenty years thereafter, any member bank desiring to retire the whole or any part of its circulating notes, may file with the Treasurer of the United States an application to sell for its account, at par and accrued interest, United States bonds securing circulation to be retired.

The Treasurer shall, at the end of each quarterly period, furnish the Federal Reserve Board with a list of such applications, and the Federal Reserve Board may, in its discretion, require the Federal reserve banks to purchase such bonds from the banks whose applications have been filed with the Treasurer at least ten days before the end of any quarterly period at which the Federal Reserve Board may direct the purchase to be made: *Provided*, That Federal reserve banks shall not be permitted to purchase an amount to exceed \$25,000,000 of such bonds in any one year, and which amount shall include bonds acquired under section four of this Act by the Federal reserve bank.

Provided further, That the Federal Reserve Board shall allot to each Federal reserve bank such proportion of such bonds as the capital and surplus of such bank shall bear to the aggregate capital and surplus of all the Federal reserve banks.

Upon notice from the Treasurer of the amount of bonds so sold for its account, each member bank shall duly assign and transfer, in writing, such bonds to the Federal reserve bank purchasing the same, and such Federal reserve bank shall, thereupon, deposit lawful money with the Treasurer of the United States for the purchase price of such bonds, and the Treasurer shall pay to the member bank selling such bonds any balance due after deducting a sufficient sum to redeem its outstanding notes secured by such bonds, which notes shall be canceled and permanently retired when redeemed.

The Federal reserve banks purchasing such bonds shall be permitted to take out an amount of circulating notes equal to the par value of such bonds.

Upon the deposit with the Treasurer of the United States of bonds so purchased, or any bonds with the circulating privilege acquired under section four of this Act, any Federal reserve bank making such deposit in the manner provided by existing law, shall be entitled to receive from

the Comptroller of the Currency circulating notes in blank, registered and countersigned as provided by law, equal in amount to the par value of the bonds so deposited.¹ Such notes shall be the obligations of the Federal reserve bank procuring the same, and shall be in form prescribed by the Secretary of the Treasury, and to the same tenor and effect as national-bank notes now provided by law. They shall be issued and redeemed under the same terms and conditions as national-bank notes except that they shall not be limited to the amount of the capital stock of the Federal reserve bank issuing them.

Upon application of any Federal reserve bank, approved by the Federal Reserve Board, the Secretary of the Treasury may issue, in exchange for United States two per centum gold bonds bearing the circulation privilege, but against which no circulation is outstanding, one-year gold notes of the United States without the circulation privilege, to an amount not to exceed one-half of the two per centum bonds so tendered for exchange, and thirty-year three per centum gold bonds without the circulation privilege for the remainder of the two per centum bonds so tendered: *Provided*, That at the time of such exchange the Federal reserve bank obtaining such one-year gold notes shall enter into an obligation with the Secretary of the Treasury binding itself to purchase from the United States for gold at the maturity of such one-year notes, an amount equal to those delivered in exchange for such bonds, if so requested by the Secretary, and at each maturity of one-year notes so purchased by such Federal reserve bank, to purchase from the United States such an amount of one-year notes as the Secretary may tender to such bank, not to exceed the amount issued to such bank in the first instance, in exchange for the two per centum United States gold bonds; said obligation to purchase at maturity such notes shall continue in force for a period not to exceed thirty years.

For the purpose of making the exchange herein provided for, the Secretary of the Treasury is authorized to issue at par Treasury notes in coupon or registered form as he may prescribe in denominations of one hundred dollars, or any multiple thereof, bearing interest at the rate of three per centum per annum, payable quarterly, such Treasury notes to be payable not more than one year from the date of their issue in gold coin of the present standard value, and to be exempt as to principal and interest from the payment of all taxes and duties of the United States except as provided by this Act, as well as from taxes in any form by or under State, municipal, or local authorities. And for the same purpose, the Secretary is authorized and empowered to issue United

¹ Under act of April 23, 1918, Federal reserve banks may issue Federal reserve bank notes in any denominations, including \$1 and \$2, against the security of United States certificates of indebtedness to the extent permitted by that act.

States gold bonds at par, bearing three per centum interest payable thirty years from date of issue, such bonds to be of the same general tenor and effect and to be issued under the same general terms and conditions as the United States three per centum bonds without the circulation privilege now issued and outstanding.

Upon application of any Federal reserve bank, approved by the Federal Reserve Board, the Secretary may issue at par such three per centum bonds in exchange for the one-year gold notes herein provided for.

Bank Reserves.

[As amended by act approved August 15, 1914 (38 Stat., 691, chap. 252); act approved June 21, 1917 (40 Stat., 232, chap. 32); act approved September 26, 1918.]

Sec. 19. Demand deposits within the meaning of this Act shall comprise all deposits payable within thirty days, and time deposits shall comprise all deposits payable after thirty days, all savings accounts and certificates of deposit which are subject to not less than thirty days' notice before payment, and all postal savings deposits.¹

Every bank, banking association, or trust company which is or which becomes a member of any Federal reserve bank shall establish and maintain reserve balances with its Federal reserve bank as follows:

(a) If not in a reserve or central reserve city, as now or hereafter defined, it shall hold and maintain with the Federal reserve bank of its district an actual net balance equal to not less than seven per centum of the aggregate amount of its demand deposits and three per centum of its time deposits.

(b) If in a reserve city, as now or hereafter defined, it shall hold and maintain with the Federal reserve bank of its district an actual net balance equal to not less than ten per centum of the aggregate amount of its demand deposits and three per centum of its time deposits: *Provided, however,* That if located in the outlying districts of a reserve city or in territory added to such a city by the extension of its corporate charter, it may, upon the affirmative vote of five members of the Federal Reserve Board, hold and maintain the reserve balances specified in paragraph (a) hereof.

(c) If in a central reserve city, as now or hereafter defined, it shall hold and maintain with the Federal reserve bank of its district an actual net balance to not less than thirteen per centum of the aggregate amount

¹ Government deposits other than postal savings deposits are not subject to reserve requirements. See section 7 of First Liberty Bond Act, approved April 24, 1917; section 8 of Second Liberty Bond Act, approved September 24, 1917, and section 8 of Third Liberty Bond Act, approved April 4, 1918.

of its demand deposits and three per centum of its time deposits: *Provided, however,* That if located in the outlying districts of a central reserve city or in territory added to such city by the extension of its corporate charter, it may, upon the affirmative vote of five members of the Federal Reserve Board, hold and maintain the reserve balances specified in paragraphs (a) or (b) thereof.

No member bank shall keep on deposit with any State bank or trust company which is not a member bank a sum in excess of ten per centum of its own paid-up capital and surplus. No member bank shall act as the medium or agent of a non-member bank in applying for or receiving discounts from a Federal reserve bank under the provisions of this Act, except by permission of the Federal Reserve Board.

The required balance carried by a member bank with a Federal reserve bank may, under the regulations and subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities: *Provided, however,* That no bank shall at any time make new loans or shall pay any dividends unless and until the total balance required by law is fully restored.

In estimating the balances required by this Act, the net difference of amounts due to and from other banks shall be taken as the basis for ascertaining the deposits against which required balances with Federal reserve banks shall be determined.

National banks, or banks organized under local laws, located in Alaska or in a dependency or insular possession or any part of the United States outside the continental United States may remain non-member banks, and shall in that event maintain reserves and comply with all the conditions now provided by law regulating them; or said banks may, with the consent of the Reserve Board, become member banks of any one of the reserve districts, and shall in that event take stock, maintain reserves, and be subject to all the other provisions of this Act.

Sec. 20. So much of sections two and three of the act of June twentieth, eighteen hundred and seventy-four, entitled "An Act fixing the amount of United States notes, providing for a redistribution of the national-bank currency, and for other purposes," as provides that the fund deposited by any national banking association with the Treasurer of the United States for the redemption of its notes shall be counted as a part of its lawful reserve as provided in the Act aforesaid, is hereby repealed. And from and after the passage of this Act such fund of five per centum shall in no case be counted by any national banking association as a part of its lawful reserve.

Bank Examinations.

Sec. 21. Section fifty-two hundred and forty, United States Revised Statutes, is amended to read as follows:

The Comptroller of the Currency, with the approval of the Secretary of the Treasury, shall appoint examiners who shall examine every member bank¹ at least twice in each calendar year and oftener if considered necessary: *Provided, however,* That the Federal Reserve Board may authorize examination by the State authorities to be accepted in the case of State banks and trust companies and may at any time direct the holding of a special examination of State banks or trust companies that are stockholders of any Federal reserve bank. The examiner making the examination of any national bank, or of any other member bank, shall have power to make a thorough examination of all the affairs of the bank, and in doing so he shall have power to administer oaths and to examine any of the officers and agents thereof under oath and shall make a full and detailed report of the condition of said bank to the Comptroller of the Currency.

The Federal Reserve Board, upon the recommendation of the Comptroller of the Currency, shall fix the salaries of all bank examiners and make report thereof to Congress. The expense of the examinations herein provided for shall be assessed by the Comptroller of the Currency upon the banks examined in proportion to assets or resources held by the banks upon the dates of examination of the various banks.

In addition to the examinations made and conducted by the Comptroller of the Currency, every Federal reserve bank may, with the approval of the Federal reserve agent or the Federal Reserve Board, provide for special examination of member banks within its district. The expense of such examinations shall be borne by the bank examined. Such examinations shall be so conducted as to inform the Federal reserve bank of the condition of its member banks and of the lines of credit which are being extended by them. Every Federal reserve bank shall at all times furnish to the Federal Reserve Board such information as may be demanded concerning the condition of any member bank within the district of the said Federal reserve bank.

No bank shall be subject to any visitatorial powers other than such as are authorized by law, or vested in the courts of justice or such as shall be or shall have been exercised or directed by Congress, or by either House thereof or by any committee of Congress or of either House duly authorized.

¹ Except banks admitted to membership in the system under authority of section 9 of this act. See section 9 of this act as amended by act approved June 21, 1917.

The Federal Reserve Board shall, at least once each year, order an examination of each Federal reserve bank, and upon joint application of ten member banks the Federal Reserve Board shall order a special examination and report of the condition of any Federal reserve bank.

[As amended by act approved June 21, 1917 (40 Stat., 232, chap. 32); act approved September 26, 1918.]

Sec. 22. (a) No member bank and no officer, director, or employee thereof shall hereafter make any loan or grant any gratuity to any bank examiner. Any bank officer, director, or employee violating this provision shall be deemed guilty of a misdemeanor and shall be imprisoned not exceeding one year or fined not more than \$5,000, or both; and may be fined a further sum equal to the money so loaned or gratuity given.

Any examiner accepting a loan or gratuity from any bank examined by him or from any officer, director, or employee thereof shall be deemed guilty of a misdemeanor and shall be imprisoned one year or fined not more than \$5,000, or both, and may be fined a further sum equal to the money so loaned or gratuity given, and shall forever thereafter be disqualified from holding office as a national bank examiner.

(b) No national bank examiner shall perform any other service for compensation while holding such office for any bank or officer, director, or employee thereof.

No examiner, public or private, shall disclose the names of borrowers or the collateral for loans of a member bank to other than the proper officers of such bank without first having obtained the express permission in writing from the Comptroller of the Currency, or from the board of directors of such bank, except when ordered to do so by a court of competent jurisdiction, or by direction of the Congress of the United States, or of either House thereof, or any committee of Congress, or of either House duly authorized. Any bank examiner violating the provisions of this subsection shall be imprisoned not more than one year or fined not more than \$5,000, or both.

(c) Except as herein provided, any officer, director, employee, or attorney of a member bank who stipulates for or receives or consents or agrees to receive any fee, commission, gift, or thing of value from any person, firm, or corporation, for procuring or endeavoring to procure for such person, firm, or corporation, or for any other person, firm, or corporation, any loan from or the purchase or discount of any paper, note, draft, check, or bill of exchange by such member bank shall be deemed guilty of a misdemeanor and shall be imprisoned not more than one year or fined not more than \$5,000, or both

(d) Any member bank may contract for, or purchase from, any of its directors or from any firm of which any of its directors is a member, any securities or other property, when (and not otherwise) such purchase is made in the regular course of business upon terms not less favorable to the bank than those offered to others, or when such purchase is authorized by a majority of the board of directors not interested in the sale of such securities or property, such authority to be evidenced by the affirmative vote or written assent of such directors: *Provided, however,* That when any director, or firm of which any director is a member, acting for or on behalf of others, sells securities or other property to a member bank, the Federal Reserve Board by regulation may, in any or all cases, require a full disclosure to be made, on forms to be prescribed by it, of all commissions or other considerations received, and whenever such director or firm, acting in his or its own behalf, sells securities or other property to the bank the Federal Reserve Board by regulation, may require a full disclosure of all profit realized from such sale.

Any member bank may sell securities or other property to any of its directors, or to a firm of which any of its directors is a member, in the regular course of business on terms not more favorable to such director or firm than those offered to others, or when such sale is authorized by a majority of the board of directors of a member bank to be evidenced by their affirmative vote or written assent: *Provided, however,* That nothing in this subsection contained shall be construed as authorizing member banks to purchase or sell securities or other property which such banks are not otherwise authorized by law to purchase or sell.

(e) No member bank shall pay to any director, officer, attorney, or employee a greater rate of interest on the deposits of such director, officer, attorney, or employee than that paid to other depositors on similar deposits with such member bank.

(f) If the directors or officers of any member bank shall knowingly violate or permit any of the agents, officers, or directors of any member bank to violate any of the provisions of this section or regulations of the board made under authority thereof, every director and officer participating in or assenting to such violation shall be held liable in his personal and individual capacity for all damages which the member bank, its shareholders, or any other persons shall have sustained in consequence of such violation.

Sec. 23. The stockholders of every national banking association shall be held individually responsible for all contracts, debts, and engagements of such association, each to the amount of his stock therein, at the par value thereof in addition to the amount invested in such stock. The

stockholders in any national banking association who shall have transferred their shares or registered the transfer thereof within sixty days next before the date of the failure of such association to meet its obligations, or with knowledge of such impending failure, shall be liable to the same extent as if they had made no such transfer, to the extent that the subsequent transferee fails to meet such liability; but this provision shall not be construed to affect in any way any recourse which such shareholders might otherwise have against those in whose names such shares are registered at the time of such failure.

Loans on Farm Lands.

[As amended by act approved Sept. 7, 1916 (39 Stat., 752, chap. 461).]

Sec. 24. Any national banking association not situated in a central reserve city may make loans secured by improved and unencumbered farm land situated within its Federal reserve district or within a radius of one hundred miles of the place in which such bank is located, irrespective of district lines, and may also make loans secured by improved and unencumbered real estate located within one hundred miles of the place in which such bank is located, irrespective of district lines; but no loan made upon the security of such farm land shall be made for a longer time than five years, and no loan made upon the security of such real estate as distinguished from farm land shall be made for a longer time than one year nor shall the amount of any such loan, whether upon such farm land or upon such real estate, exceed fifty per centum of the actual value of the property offered as security. Any such bank may make such loans, whether secured by such farm land or such real estate, in an aggregate sum equal to twenty-five per centum of its capital and surplus or to one-third of its time deposits and such banks may continue hereafter as heretofore to receive time deposits and to pay interest on the same.

The Federal Reserve Board shall have power from time to time to add to the list of cities in which national banks shall not be permitted to make loans secured upon real estate in the manner described in this section.

Foreign Branches.

[As amended by act approved Sept. 7, 1916 (39 Stat., 752, chap. 461); act approved Sept. 17, 1919.]

Sec. 25. Any national banking association possessing a capital and surplus of \$1,000,000 or more may file application with the Federal Reserve Board for permission to exercise, upon conditions and under

such regulations as may be prescribed by the said board, either or both of the following powers:

First. To establish branches in foreign countries or dependencies or insular possessions of the United States for the furtherance of the foreign commerce of the United States, and to act if required to do so as fiscal agents of the United States.

Second. To invest an amount not exceeding in the aggregate ten per centum of its paid-in capital stock and surplus in the stock of one or more banks or corporations chartered or incorporated under the laws of the United States or of any State thereof, and principally engaged in international or foreign banking, or banking in a dependency or insular possession of the United States either directly or through the agency, ownership, or control of local institutions in foreign countries, or in such dependencies or insular possessions.

Until January 1, 1921, any national banking association, without regard to the amount of its capital and surplus, may file application with the Federal Reserve Board for permission, upon such conditions and under such regulations as may be prescribed by said board, to invest an amount not exceeding in the aggregate 5 per centum of its paid-in capital and surplus in the stock of one or more corporations chartered or incorporated under the laws of the United States or of any State thereof and, regardless of its location, principally engaged in such phases of international or foreign financial operations as may be necessary to facilitate the export of goods, wares, or merchandise from the United States or any of its dependencies or insular possessions to any foreign country: *Provided, however,* That in no event shall the total investments authorized by this section by any one national bank exceed 10 per centum of its capital and surplus.

Such application shall specify the name and capital of the banking association filing it, the powers applied for, and the place or places where the banking or financial operations proposed are to be carried on. The Federal Reserve Board shall have power to approve or to reject such application in whole or in part if for any reason the granting of such application is deemed inexpedient, and shall also have power from time to time to increase or decrease the number of places where such banking operations may be carried on.

Every national banking association operating foreign branches shall be required to furnish information concerning the condition of such branches to the Comptroller of the Currency upon demand, and every member bank investing in the capital stock of banks or corporations described above shall be required to furnish information concerning the condition of such banks or corporations to the Federal Reserve Board

upon demand, and the Federal Reserve Board may order special examinations of the said branches, banks, or corporations at such time or times as it may deem best.

Before any national bank shall be permitted to purchase stock in any such corporation the said corporation shall enter into an agreement or undertaking with the Federal Reserve Board to restrict its operations or conduct its business in such manner or under such limitations and restrictions as the said board may prescribe for the place or places wherein such business is to be conducted. If at any time the Federal Reserve Board shall ascertain that the regulations prescribed by it are not being complied with, said board is hereby authorized and empowered to institute an investigation of the matter and to send for persons and papers, subpoena witnesses, and administer oaths in order to satisfy itself as to the actual nature of the transactions referred to. Should such investigation result in establishing the failure of the corporation in question, or of the national bank or banks which may be stockholders therein, to comply with the regulations laid down by the said Federal Reserve Board, such national banks may be required to dispose of stock holdings in the said corporation upon reasonable notice.

Every such national banking association shall conduct the accounts of each foreign branch independently of the accounts of other foreign branches established by it and of its home office, and shall at the end of each fiscal period transfer to its general ledger the profit or loss accrued at each branch as a separate item.

Any director or other officer, agent, or employer of any member bank may, with the approval of the Federal Reserve Board, be a director or other officer, agent, or employee of any such bank or corporation above mentioned in the capital stock of which such member bank shall have invested as hereinbefore provided, without being subject to the provisions of section eight of the Act approved October fifteenth, nineteen hundred and fourteen, entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes."¹

Banking Corporations Authorized to Do Foreign Banking Business.

[Added by Act of December 24, 1919, as amended by act approved
February 27, 1921.]

Sec. 25. (a) Corporations to be organized for the purpose of engaging in international or foreign banking or other international or foreign financial operations, or in banking or other financial operations in a dependency or insular possession of the United States, either directly or through the agency, ownership, or control of local institutions in

¹ The Clayton Act.

foreign countries, or in such dependencies or insular possessions as provided by this section, and to act when required by the Secretary of the Treasury as fiscal agents of the United States, may be formed by any number of natural persons, not less in any case than five: *Provided*, That nothing in this section shall be construed to deny the right of the Secretary of the Treasury to use any corporation organized under this section as depositaries in Panama and the Panama Canal Zone, or in the Philippine Islands and other insular possessions and dependencies of the United States.

Such persons shall enter into articles of association which shall specify in general terms the objects for which the association is formed and may contain any other provisions not inconsistent with law which the association may see fit to adopt for the regulation of its business and the conduct of its affairs.

Such articles of association shall be signed by all of the persons intending to participate in the organization of the corporation and, thereafter, shall be forwarded to the Federal Reserve Board and shall be filed and preserved in its office. The persons signing the said articles of association shall under their hands, make an organization certificate which shall specifically state:

First. The name assumed by such corporation, which shall be subject to the approval of the Federal Reserve Board.

Second. The place or places where its operations are to be carried on.

Third. The place in the United States where its home office is to be located.

Fourth. The amount of its capital stock and the number of shares into which the same shall be divided.

Fifth. The names and places of business or residence of the persons executing the certificate and the number of shares to which each has subscribed.

Sixth. The fact that the certificate is made to enable the persons subscribing the same, and all other persons, firms, companies, and corporations, who or which may thereafter subscribe to or purchase shares of the capital stock of such corporation, to avail themselves of the advantages of this section.

The persons signing the organization certificate shall duly acknowledge the execution thereof before a judge of some court of record or notary public, who shall certify thereto under the seal of such court or notary, and thereafter the certificate shall be forwarded to the Federal Reserve Board to be filed and preserved in its office. Upon duly making and filing articles of association and an organization certificate, and after the Federal Reserve Board has approved the same and issued a permit to

begin business, the association shall become and be a body corporate, and as such and in the name designated therein shall have power to adopt and use a corporate seal, which may be changed at the pleasure of its board of directors; to have succession for a period of twenty years unless sooner dissolved by the act of the shareholders owning two-thirds of the stock or by an Act of Congress or unless its franchises become forfeited by some violation of law; to make contracts; to sue and be sued, complain, and defend in any court of law or equity; to elect or appoint directors, all of whom shall be citizens of the United States; and, by its board of directors, to appoint such officers and employees as may be deemed proper, define their authority and duties, require bonds of them, and fix the penalty thereof, dismiss such officers or employees, or any thereof, at pleasure and appoint others to fill their places; to prescribe, by its board of directors, by-laws not inconsistent with law or with the regulations of the Federal Reserve Board regulating the manner in which its stock shall be transferred, its directors elected or appointed, its officers and employees appointed, its property transferred, and the privileges granted to it by law exercised and enjoyed.

Each corporation so organized shall have power, under such rules and regulations as the Federal Reserve Board may prescribe:

(a) To purchase, sell, discount, and negotiate, with or without its indorsement or guaranty, notes, drafts, checks, bills of exchange, acceptances, including bankers' acceptances, cable transfers, and other evidences of indebtedness; to purchase and sell, with or without its indorsement or guaranty, securities including the obligations of the United States or of any State thereof but not including shares of stock in any corporation except as herein provided; to accept bills or drafts drawn upon it subject to such limitations and restrictions as the Federal Reserve Board may impose; to issue letters of credit; to purchase and sell coin, bullion, and exchange; to borrow and to lend money; to issue debentures, bonds, and promissory notes under such general conditions as to security and such limitations as the Federal Reserve Board may prescribe, but in no event having liabilities outstanding thereon at any one time exceeding ten times its capital stock and surplus; to receive deposits outside of the United States and to receive only such deposits within the United States as may be incidental to or for the purpose of carrying out transactions in foreign countries or dependencies or insular possessions of the United States; and generally to exercise such powers as are incidental to the powers conferred by this Act or as may be usual, in the determination of the Federal Reserve Board, in connection with the transaction of the business of banking or other financial operations in the countries, colonies, dependencies, or

possessions in which it shall transact business and not inconsistent with the powers specifically granted herein. Nothing contained in this section shall be construed to prohibit the Federal Reserve Board, under its power to prescribe rules and regulations, from limiting the aggregate amount of liabilities of any or all classes incurred by the corporation and outstanding at any one time. Whenever a corporation organized under this section receives deposits in the United States authorized by this section it shall carry reserves in such amounts as the Federal Reserve Board may prescribe, but in no event less than 10 per centum of its deposits.

(b) To establish and maintain for the transaction of its business branches or agencies in foreign countries, their dependencies or colonies, and in the dependencies or insular possessions of the United States, at such places as may be approved by the Federal Reserve Board and under such rules and regulations as it may prescribe, including countries or dependencies not specified in the original organization certificate.

(c) With the consent of the Federal Reserve Board to purchase and hold stock or other certificates of ownership in any other corporation organized under the provisions of this section, or under the laws of any foreign country or a colony or dependency thereof, or under the laws of any State, dependency, or insular possession of the United States but not engaged in the general business of buying or selling goods, wares, merchandise or commodities in the United States, and not transacting any business in the United States except such as in the judgment of the Federal Reserve Board may be incidental to its international or foreign business: *Provided, however,* That, except with the approval of the Federal Reserve Board, no corporation organized hereunder shall invest in any one corporation an amount in excess of 10 per centum of its own capital and surplus, except in a corporation engaged in the business of banking, when 15 per centum of its capital and surplus may be so invested: *Provided, further,* That no corporation organized hereunder shall purchase, own, or hold stock or certificates of ownership in any other corporation organized hereunder or under the laws of any State which is in substantial competition therewith, or which holds stocks or certificates of ownership in corporations which are in substantial competition with the purchasing corporation.

Nothing contained herein shall prevent corporations organized hereunder from purchasing and holding stock in any corporation where such purchase shall be necessary to prevent a loss upon a debt previously contracted in good faith; and stock so purchased or acquired in corporations organized under this section shall within six months from such purchase be sold or disposed of at public or private sale unless the time to so dispose of same is extended by the Federal Reserve Board.

No corporation organized under this section shall carry on any part of its business in the United States except such as, in the judgment of the Federal Reserve Board, shall be incidental to its international or foreign business: *And provided further*, That except such as is incidental and preliminary to its organization no such corporation shall exercise any of the powers conferred by this section until it has been duly authorized by the Federal Reserve Board to commence business as a corporation organized under the provisions of this section.

No corporation organized under this section shall engage in commerce or trade in commodities except as specifically provided in this section, nor shall it either directly or indirectly control or fix or attempt to control or fix the price of any such commodities. The charter of any corporation violating this provision shall be subject to forfeiture in the manner hereinafter provided in this section. It shall be unlawful for any director, officer, agent, or employee of any such corporation to use or to conspire to use the credit, the funds, or the power of the corporation to fix or control the price of any such commodities, and any such person violating this provision shall be liable to a fine of not less than \$1,000 and not exceeding \$5,000 or imprisonment not less than one year and not exceeding five years, or both, in the discretion of the court.

[As amended by Act approved June 14, 1921.]

No corporation shall be organized under the provisions of this section with a capital stock of less than \$2,000,000, one-quarter of which must be paid in before the corporation may be authorized to begin business, and the remainder of the capital stock of such corporation shall be paid in installments of at least 10 per centum on the whole amount to which the corporation shall be limited as frequently as one installment at the end of each succeeding two months from the time of the commencement of its business operations until the whole of the capital stock shall be paid in: *Provided, however*, That whenever \$2,000,000 of the capital stock of any corporation is paid in the remainder of the corporation's capital stock or any unpaid part of such remainder may, with the consent of the Federal Reserve Board and subject to such regulations and conditions as it may prescribe, be paid in upon call from the board of directors; such unpaid subscriptions, however, to be included in the maximum of 10 per centum of the national bank's capital and surplus which a national bank is permitted under the provisions of this Act to hold in stock of corporations engaged in business of the kind described in this section and in section 25 of the Federal Reserve Act as amended: *Provided further*, That no such corporation shall have liabilities out-

standing at any one time upon its debentures, bonds, and promissory notes in excess of ten times its paid-in capital and surplus.

The capital stock of any such corporation may be increased at any time, with the approval of the Federal Reserve Board, by a vote of two-thirds of its shareholders or by unanimous consent in writing of the shareholders without a meeting and without a formal vote, but any such increase of capital shall be fully paid in within ninety days after such approval; and may be reduced in like manner, provided that in no event shall it be less than \$2,000,000. No corporation, except as herein provided, shall during the time it shall continue its operations withdraw or permit to be withdrawn, either in the form of dividends or otherwise, any portion of its capital. Any national banking association may invest in the stock of any corporation organized under the provisions of this section, but the aggregate amount of stock held in all corporations engaged in business of the kind described in this section and in section 25 of the Federal Reserve Act as amended shall not exceed 10 per centum of the subscribing bank's capital and surplus.

A majority of the shares of the capital stock of any such corporation shall at all times be held and owned by citizens of the United States, by corporations the controlling interest in which is owned by citizens of the United States, chartered under the laws of the United States or of a State of the United States, or by firms or companies, the controlling interest in which is owned by citizens of the United States. The provisions of section 8 of the act approved October 15, 1914, entitled "An act to supplement existing laws against unlawful restraints and monopolies, and for other purposes," as amended by the acts of May 15, 1916, and September 7, 1916, shall be construed to apply to the directors, other officers, agents, or employees of corporations organized under the provisions of this section: *Provided, however,* That nothing herein contained shall (1) prohibit any director or other officer, agent, or employee of any member bank, who has procured the approval of the Federal Reserve Board, from serving at the same time as a director or other officer, agent or employee of any corporation organized under the provisions of this section in whose capital stock such member bank shall have invested; or (2) prohibit any director or other officer, agent, or employee of any corporation organized under the provisions of this section, who has procured the approval of the Federal Reserve Board, from serving at the same time as a director or other officer, agent or employee of any other corporation in whose capital stock such first-mentioned corporation shall have invested under the provisions of this section.

No member of the Federal Reserve Board shall be an officer or director of any corporation organized under the provisions of this section, or

of any corporation engaged in similar business organized under the laws of any State, nor hold stock in any such corporation, and before entering upon his duties as a member of the Federal Reserve Board he shall certify under oath to the Secretary of the Treasury that he has complied with this requirement.

Shareholders in any corporation organized under the provisions of this section shall be liable for the amount of their unpaid stock subscriptions. No such corporation shall become a member of any Federal reserve bank.

Should any corporation organized hereunder violate or fail to comply with any of the provisions of this section, all of its rights, privileges, and franchises derived herefrom may thereby be forfeited. Before any such corporation shall be declared dissolved, or its rights, privileges, and franchises forfeited, any non-compliance with, or violation of such laws shall, however, be determined and adjudged by a court of the United States of competent jurisdiction in a suit brought for that purpose in the district or territory in which the home office of such corporation is located, which suit shall be brought by the United States at the instance of the Federal Reserve Board or the Attorney General. Upon adjudication of such non-compliance or violation, each director and officer who participated in, or assented to, the illegal act or acts, shall be liable in his personal or individual capacity for all damages which the said corporation shall have sustained in consequence thereof. No dissolution shall take away or impair any remedy against the corporation, its stockholders, or officers for any liability or penalty previously incurred.

Any such corporation may go into voluntary liquidation and be closed by a vote of its shareholders owning two-thirds of its stock.

Whenever the Federal Reserve Board shall become satisfied of the insolvency of any such corporation, it may appoint a receiver who shall take possession of all of the property and assets of the corporation and exercise the same rights, privileges, powers, and authority with respect thereto as are now exercised by receivers of national banks appointed by the Comptroller of the Currency of the United States: *Provided, however,* That the assets of the corporation subject to the laws of other countries or jurisdictions shall be dealt with in accordance with the terms of such laws.

Every corporation organized under the provisions of this section shall hold a meeting of its stockholders annually upon a date fixed in its by-laws, such meeting to be held at its home office in the United States. Every such corporation shall keep at its home office books containing the names of all stockholders thereof, and the names and addresses of the members of its board of directors, together with copies of all reports

made by it to the Federal Reserve Board. Every such corporation shall make reports to the Federal Reserve Board at such times and in such form as it may require; and shall be subject to examination once a year and at such other times as may be deemed necessary by the Federal Reserve Board by examiners appointed by the Federal Reserve Board, the cost of such examinations, including the compensation of the examiners, to be fixed by the Federal Reserve Board and to be paid by the corporation examined.

The directors of any corporation organized under the provisions of this section may, semiannually, declare a dividend of so much of the net profits of the corporation as they shall judge expedient; but each corporation shall, before the declaration of a dividend, carry one-tenth of its net profits of the preceding half year to its surplus fund until the same shall amount to 20 per centum of its capital stock.

Any corporation organized under the provisions of this section shall be subject to tax by the State within which its home office is located in the same manner and to the same extent as other corporations organized under the laws of that State which are transacting a similar character of business. The shares of stock in such corporation shall also be subject to tax as the personal property of the owners or holders thereof in the same manner and to the same extent as the shares of stock in similar State corporations.

Any corporation organized under the provisions of this section may at any time within the two years next previous to the date of the expiration of its corporate existence, by a vote of the shareholders owning two-thirds of its stock, apply to the Federal Reserve Board for its approval to extend the period of its corporate existence for a term of not more than twenty years, and upon certified approval of the Federal Reserve Board such corporation shall have its corporate existence for such extended period unless sooner dissolved by the act of the shareholders owning two-thirds of its stock, or by an Act of Congress or unless its franchise becomes forfeited by some violation of law.

Any bank or banking institution, principally engaged in foreign business, incorporated by special law of any State or of the United States or organized under the general laws of any State or of the United States and having an unimpaired capital sufficient to entitle it to become a corporation under the provisions of this section may, by the vote of the shareholders owning not less than two-thirds of the capital stock of such bank or banking association, with the approval of the Federal Reserve Board, be converted into a Federal corporation of the kind authorized by this section with any name approved by the Federal Reserve Board: *Provided, however,* That said conversion shall not be in

contravention of the State law. In such case the articles of association and organization certificate may be executed by a majority of the directors of the bank or banking institution, and the certificate shall declare that the owners of at least two-thirds of the capital stock have authorized the directors to make such certificate and to change or convert the bank or banking institution into a Federal corporation. A majority of the directors, after executing the articles of association and the organization certificate, shall have power to execute all other papers and to do whatever may be required to make its organization perfect and complete as a Federal corporation. The shares of any such corporation may continue to be for the same amount each as they were before the conversion, and the directors may continue to be directors of the corporation until others are elected or appointed in accordance with the provisions of this section. When the Federal Reserve Board has given to such corporation a certificate that the provisions of this section have been complied with, such corporation and all its stockholders, officers, and employees, shall have the same powers and privileges, and shall be subject to the same duties, liabilities, and regulations, in all respects, as shall have been prescribed by this section for corporations originally organized hereunder.

Every officer, director, clerk, employee, or agent of any corporation organized under this section who embezzles, abstracts, or willfully misapplies any of the moneys, funds, credits, securities, evidences of indebtedness or assets of any character of such corporation; or who, without authority from the directors, issues or puts forth any certificate of deposit, draws any order or bill of exchange, makes any acceptance, assigns any note, bond, debenture, draft, bill of exchange, mortgage, judgment, or decree; or who makes any false entry in any book, report, or statement of such corporation with intent, in either case, to injure or defraud such corporation or any other company, body politic or corporate, or any individual person, or to deceive any officer of such corporation, the Federal Reserve Board, or any agent or examiner appointed to examine the affairs of any such corporation; and every receiver of any such corporation and every clerk or employee of such receiver who shall embezzle, abstract, or willfully misapply or wrongfully convert to his own use any moneys, funds, credits, or assets of any character which may come into his possession or under his control in the execution of his trust or the performance of the duties of his employment; and every such receiver or clerk or employee of such receiver who shall, with intent to injure or defraud any person, body politic or corporate, or to deceive or mislead the Federal Reserve Board, or any agent or examiner appointed to examine the affairs of such receiver, shall make any false

entry in any book, report, or record of any matter connected with the duties of such receiver; and every person who with like intent aids or abets any officer, director, clerk, employee, or agent of any corporation organized under this section, or receiver or clerk or employee of such receiver as aforesaid in any violation of this section, shall upon conviction thereof be imprisoned for not less than two years nor more than ten years, and may also be fined not more than \$5,000, in the discretion of the court.

Whoever being connected in any capacity with any corporation organized under this section represents in any way that the United States is liable for the payment of any bond or other obligation, or the interest thereon, issued or incurred by any corporation organized hereunder, or that the United States incurs any liability in respect of any act or omission of the corporation, shall be punished by a fine of not more than \$10,000 and by imprisonment for not more than five years.

Sec. 26. All provisions of law inconsistent with or superseded by any of the provisions of this Act are to that extent and to that extent only hereby repealed: *Provided*, Nothing in this Act contained shall be construed to repeal the parity provision or provisions contained in an Act approved March fourteenth, nineteen hundred, entitled "An Act to define and fix the standard of value, to maintain the parity of all forms of money issued or coined by the United States, to refund the public debt, and for other purposes," and the Secretary of the Treasury may, for the purpose of maintaining such parity and to strengthen the gold reserve, borrow gold on the security of United States bonds authorized by section two of the Act last referred to or for one-year gold notes bearing interest at a rate of not to exceed three per centum per annum, or sell the same if necessary to obtain gold. When the funds of the Treasury on hand justify, he may purchase and retire such outstanding bonds and notes.

[As amended by act approved August 4, 1914 (38 Stat., 682, chap. 225).]

Sec. 27. The provisions of the Act of May thirtieth, nineteen hundred and eight, authorizing national currency associations, the issue of additional national-bank circulation, and creating a National Monetary Commission, which expires by limitation under the terms of such Act on the thirtieth day of June, nineteen hundred and fourteen, are hereby extended to June thirtieth, nineteen hundred and fifteen, and sections fifty-one hundred and fifty-three, fifty-one hundred and seventy-two,¹

¹ Amended as to section 5172, Revised Statutes, by act approved March 3, 1919.

fifty-one hundred and ninety-one, and fifty-two hundred and fourteen of the Revised Statutes of the United States, which were amended by the Act of May thirtieth, nineteen hundred and eight, are hereby re-enacted to read as such sections read prior to May thirtieth, nineteen hundred and eight, subject to such amendments or modifications as are prescribed in this Act: *Provided, however*, That section nine of the Act first referred to in this section is hereby amended so as to change the tax rates fixed in said Act by making the portion applicable thereto read as follows:

National banking associations having circulating notes secured otherwise than by bonds of the United States, shall pay for the first three months a tax at the rate of three per centum per annum upon the average amount of such of their notes in circulation as are based upon the deposit of such securities, and afterwards an additional tax rate of one-half of one per centum per annum for each month until a tax of six per centum is reached, and thereafter such tax of six per centum per annum upon the average amount of such notes: *Provided further*, That whenever in his judgment he may deem it desirable, the Secretary of the Treasury shall have power to suspend the limitations imposed by section one and section three of the Act referred to in this section, which prescribe that such additional circulation secured otherwise than by bonds of the United States shall be issued only to National banks having circulating notes outstanding secured by the deposit of bonds of the United States to an amount not less than forty per centum of the capital stock of such banks, and to suspend also the conditions and limitations of section five of said Act except that no bank shall be permitted to issue circulating notes in excess of one hundred and twenty-five per centum of its unimpaired capital and surplus. He shall require each bank and currency association to maintain on deposit in the Treasury of the United States a sum in gold sufficient in his judgment for the redemption of such notes, but in no event less than five per centum. He may permit National banks, during the period for which such provisions are suspended, to issue additional circulation under the terms and conditions of the Act referred to as herein amended: *Provided further*, That the Secretary of the Treasury, in his discretion, is further authorized to extend the benefits of this Act to all qualified State banks and trust companies, which have joined the Federal reserve system, or which may contract to join within fifteen days after the passage of this Act.

Sec. 28. Section fifty-one hundred and forty-three of the Revised Statutes is hereby amended and re-enacted to read as follows: Any association formed under this title may, by the vote of shareholders owning two-thirds of its capital stock, reduce its capital to any sum not below

the amount required by this title to authorize the formation of associations; but no such reduction shall be allowable which will reduce the capital of the association below the amount required for its outstanding circulation, nor shall any reduction be made until the amount of the proposed reduction has been reported to the Comptroller of the Currency and such reduction has been approved by the said Comptroller of the Currency and by the Federal Reserve Board, or by the organization committee pending the organization of the Federal Reserve Board.

Sec. 29. If any clause, sentence, paragraph, or part of this Act shall for any reason be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder of this Act, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof directly involved in the controversy in which such judgment shall have been rendered.

Sec. 30. The right to amend, alter, or repeal this Act is hereby expressly reserved.

The Federal Reserve Banks and the Currency.

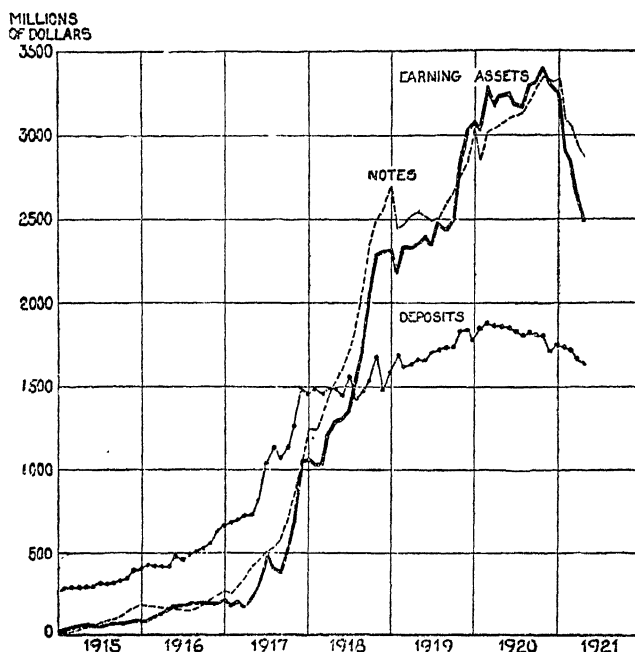
From the Monthly Review of the Federal Reserve Bank of New York, May, 1921, p. 12.

For the half century prior to 1914 the United States suffered from an inelastic currency. At times there was too much currency and at other times too little. When there was too much currency for the needs of business there was no way of reducing it, interest rates fell very low and speculation was encouraged. On the other hand, almost every autumn when large amounts of currency were needed for the harvests there was difficulty in getting together enough currency; the same was true in the cities at the Christmas shopping seasons. This scarcity of currency at such seasons generally brought about very high interest rates, and when times of real apprehension occurred, as in the autumn of 1907, every bank and many individuals began to hoard currency, which instead of helping the situation only accentuated its difficulties.

After the panic of 1907 Congress determined to put an end to the inelasticity of our currency and to provide a currency which would expand and contract in accordance with the needs of industry, commerce and agriculture. Without disturbing the existing forms of currency, namely: gold, gold certificates, silver, silver certificates, legal-tender notes and National bank notes, and without disturbing the rights, powers and functions of existing national banks, State banks and trust companies, Congress created twelve Federal reserve banks to hold the banking reserves of the country and to issue an elastic currency, re-

sponsive to the needs of the country. The gold, which is the basis of bank credit and banking power, was transferred from the thousands of banks and trust companies and placed in these twelve great reservoirs to serve as the basis for such additional credit as the country might need, whether in the form of additional deposits or additional currency. The amount of gold now held by the Federal reserve banks is \$2,300,000,000. When this gold was scattered about in the hands of the people and in the twenty-five thousand banks of the country there was no common reservoir to which they could turn and each bank feared lest its supply should run out. But now that the reservoir is formed and is available to all member banks in accordance with their needs no such fear exists. For any member bank, by discounting with its Federal reserve bank the paper of its industrial, commercial or agricultural customers, or paper secured by Government war obligations, may get credit from the Federal reserve bank either in the form of a deposit with the bank or in the form of Federal reserve notes.

We pay our bills in two ways, either by drawing checks against our deposit account in our bank, or by means of hand-to-hand currency. Experience shows that for every five or six dollars of bank deposits a dollar of hand-to-hand currency is necessary in order that we may pay for things in our accustomed manner. During the war bank deposits increased very greatly. This increase in bank deposits would not have occurred unless it had been possible to increase hand-to-hand currency proportionately. Consequently the member banks had to come to the Federal reserve banks and discount with them a very large volume of their paper in order to secure the hand-to-hand currency, in the form of Federal reserve notes, which their customers required. The war, the greatest emergency the world has known, tested the note-issuing powers of the Federal reserve banks and found them thoroughly responsive to the *increasing* needs of the country. The following diagram, giving graphically the principal figures of the twelve Federal reserve banks, shows both how notes increased in and after the war and how they have now begun to *decrease*. The reduction in the volume of notes outstanding now amounts to a little more than 16 per cent.



Earning Assets, Federal Reserve Note Circulation and Member Bank Reserve Deposits, All Federal Reserve Banks

Each Federal reserve bank keeps on hand at all times an immense supply of unissued Federal reserve notes, aggregating for the entire Federal Reserve System over a billion dollars. These Federal reserve notes are called into circulation as the member banks need them. They get notes by drawing checks on their deposit accounts and cashing them in reserve notes or other currency, just as an individual would do at his own bank. Each member bank carries on hand such currency as it finds the demands of its customers require. It knows that at any time it can get additional currency promptly from its reserve bank, consequently when it accumulates more currency than it needs it sends the excess in to the reserve bank. The reserve bank pays shipping costs on currency both to and from out-of-town member banks. This greatly facilitates the prompt reduction of the volume of currency as soon as it is not needed and economizes the use of currency, since with the element of cost removed member banks carry only what is absolutely required. When notes are returned to the reserve bank they are automatically withdrawn from circulation until called for again by some member bank.

The volume of notes handled by the reserve banks is very great. In

the New York bank about 300 clerks are constantly sorting, counting, and shipping currency. On the average about 2,500,000 notes are handled by the money counters every day.

Transferring Funds Under the Federal Reserve System.

*From the Monthly Review of the Federal Reserve Bank of New York,
June, 1921, p. 12.*

Only a few years ago a man in Chicago having a bill to pay in New York would usually buy "New York exchange," in just the same way as a New York merchant buys London exchange in the course of overseas trade. Domestic exchange was subject to many of the rules that govern the foreign exchanges; it fluctuated, was bought and sold, and registered the ebb and flow of business currents. Often, as in the foreign exchanges, the shipment of gold or currency was required in order to settle balances between different parts of the country. These shipments were expensive, troublesome, and subject to the hazards of transportation. There was a normal seasonal movement toward the west in the autumn, when the crops were being moved, and a flow back to New York in the winter when goods were being paid for and investments made. All of this was expensive, not only because of the cost of shipment and insurance but because of the unproductivity of funds while in transit.

Under the Federal Reserve system shipments of gold and currency for the purpose of settling balances have been almost wholly eliminated. While writers still describe movements and transfers of funds quite as if shipments were being made, they refer to transfers accomplished instantly and at par over the wires of the Federal Reserve system. This method has established complete fluidity of funds in the United States; there are no longer the former barriers preventing funds from flowing freely wherever the demands of commerce, industry, and agriculture dictate. Physical shipments are now practically restricted to the supplying of hand-to-hand currency for use as till money to member banks by their reserve banks and to the return to the reserve banks of such currency as is not needed by the business of the country.

The medium through which balances are settled under the Federal Reserve System is the gold settlement fund, consisting at present of about \$450,000,000. It is lodged with the Treasurer of the United States, and constitutes a part of the gold reserves of the twelve Federal reserve banks. The portion of the fund which each reserve bank owns changes each business day, and those changes are recorded on the books.

of the Federal Reserve Board. The volume of settlements of all kinds made through the fund averages nearly \$300,000,000 a day, and in the course of the year amounts to an immense sum. The following table shows settlements of the Federal Reserve Bank of New York through the fund each year since it was first operated.

1920	\$48,841,000,000
1919	41,933,000,000
1918	32,936,000,000
1917	17,119,000,000
1916	2,335,000,000
1915	556,000,000

The changes in the proportionate ownership of the fund arise from the transactions between the various reserve districts which are cleared through the reserve banks, one large element in these transactions being the collection and clearance of immense volumes of checks representing the daily turnover of commerce and industry.

The business and agricultural interests of the country derive a great advantage from these prompt settlements. Suppose a merchant in New York deposits in his bank a check for \$50,000 drawn upon a bank in San Francisco. Formerly the check would travel to San Francisco, where on arrival it would be charged to the account of the man who drew it, and his bank would mail the New York bank a New York check in payment. The \$50,000 would not be available to the merchant at his New York bank until the check arrived, at least ten, and probably twelve days after the merchant deposited the original check. Now the time is cut at least in half, because the old method of remitting by mail across the continent has been eliminated. The mail remittance is unnecessary because the San Francisco bank upon which the check is drawn makes payment at the San Francisco Reserve Bank. The same day the funds are transferred through the gold settlement fund to the New York Reserve Bank, which in turn settles immediately with the bank that had presented the check for collection.

The gold settlement fund and the private wire system connecting the reserve banks permit also another new and important service to the commerce of the country. This service, which is free, provides for the immediate transfer of funds by telegraph at par. Assume that the \$50,000 payment due from the man in San Francisco to the merchant in New York had to be made instantly, and could not wait for a check to be transmitted through the mail. His bank would charge his account, and at the same time instruct the San Francisco Reserve Bank to telegraph the New York Reserve Bank, asking it to place \$50,000 to the credit of the New York merchant in his own bank. The San Francisco

member bank is charged \$50,000 on the books of the reserve bank, and \$50,000 in the gold settlement fund passes from the ownership of the San Francisco to the New York Reserve Bank. Thus the transaction is completed. Usually such transfers are for large sums; to make a large number of small transfers, which might equally well have been made by check, would clog unduly the private wire system of the reserve banks and hamper the efficiency of the service.

The number of wire transfers has been increasing rapidly. At the beginning of 1920 the number of such transfers made by the New York Reserve Bank average 363 a day; at the end of the year the average was 712 a day. The growth of its use is shown in the following table, which includes transfers made for the United States Treasury.

	Number.	Amount.
1920	147,302	\$17,022,000,000
1919	82,321	18,245,000,000
1918	39,099	19,384,000,000
1917	10,302	6,768,000,000
1916	2,971	485,000,000

Collecting Checks Under the Federal Reserve System.

From the Monthly Review of the Federal Reserve Bank of New York, July, 1921, p. 12.

Broadly speaking, the Federal Reserve Act of 1913 attempted to do for the check currency of the country what the National Bank Act of 1863-4 and supplementary legislation did for the bank note currency of the country, namely, to make it circulate at par. While, of course, Congress did not attempt to insure the goodness of individual checks as it did the goodness of National bank notes, it eliminated a serious obstacle in the way of the direct and economical settlement of business transactions. This was a matter of increasing importance because in the fifty years which had elapsed since the passage of the National Bank Act more and more of the country's financial settlements were being made by check, and hand-to-hand currency was being more and more restricted to minor payments.

Just as in 1863 the notes of most country banks circulated at less than face value, so in 1913 the checks of most country banks and some city banks were paid at less than face value. These deductions, known as exchange charges, were explained on the theory that sometimes currency might have to be shipped in remitting for checks presented for collection.

Besides being an element of expense to business, exchange charges were the direct cause for the development of an indirect method of collecting checks. These exchange charges varied in amount in different localities, and banks having checks to collect on points where exchange charges were high, sent them to banks in other towns where checks were received at par or at a low rate of exchange; these banks sent them on to other banks until at last they were presented for collection at the banks upon which they were drawn. Thus exchange charges operated like mountains in the path of a river, forcing it to take a roundabout course, instead of a straight route to the sea.

Obviously, the time taken in collecting checks was unnecessarily extended, which meant that the period during which funds were unproductive was unnecessarily protracted. The loss of interest involved, and the exchange charges deducted, amounted to a considerable annual tax upon business, paid sometimes in money, and sometimes by maintaining balances large enough to take care of the loss.

The Federal Reserve Act seeks to eliminate exchange on checks presented by the Federal reserve banks. This permitted direct collections. All member banks may if they wish send checks on other member banks, or on most non-member banks, to the reserve bank for collection, receiving credit for them according to a published time schedule. The reserve bank generally sends such checks as are drawn upon banks in its district to those banks individually, and sends to other reserve banks for collection the checks drawn upon banks in other districts.

The process of settlement upon the books of the reserve bank is simple. A bank, upon receiving from the reserve bank a letter containing checks presented for collection, remits in currency or by check upon its balance at the reserve bank, or upon a suitable correspondent bank.

Last month in the Review the system by which balances are transferred between reserve banks over private telegraph wires was described in detail. That system is essential to the smooth working of check collections between banks in different reserve districts, and was established primarily for its furtherance. A bank in Oakland, for instance, remits to the San Francisco Reserve Bank for checks which paid debts in New York just as it remits for checks which paid debts in Sacramento. But in order for the New York Reserve Bank to settle with its member, the San Francisco Reserve Bank transfers each day over the telegraph amounts representing checks which the New York Reserve Bank sent to it for collection.

On the whole, the new system cuts about in half the time required for collecting the country's checks. Furthermore, checks on over 90 per cent of all banks in the country are now payable at full value.

Taken together, these two changes have resulted in a great saving to the business, industrial and agricultural interests of the country. It is true that time and distance, which are the warrant for collection charges now made by the banks, as distinguished from the so-called exchange charges, have not been eliminated, but with the reduction of the time element, collection charges have been much reduced. Formerly New York Clearing House banks charged one-quarter of one per cent for collecting checks drawn upon Pacific Coast banks. This charge, which a customer paid for the immediate use of the money represented in a check, and therefore an interest charge covering the time required to collect it, has now been reduced to one-tenth of one per cent, and collection charges on other points have fallen accordingly.

A very large proportion of all the checks circulating in the country is handled by the Federal reserve banks. In 1920 the twelve reserve banks handled for collection 447,000,000 checks at a value of \$157,000,000,000. The rapid growth of the system is indicated by the figures in the following table, which show the average monthly volume of checks handled by the New York Reserve Bank:

Date.	Average Number of Items Handled per Month.	Average Amount per Month.
1915	180,316	\$191,000,000
1916	570,114	430,000,000
1917	1,617,348	1,675,000,000
1918	2,945,800	3,548,000,000
1919	6,205,326	4,712,000,000
1920	7,253,035	4,610,000,000
1921 ¹	7,993,226	3,424,000,000

To carry on this work requires a force in the transit department of the New York Reserve Bank of about 400 persons, who handle on the average about 275,000 checks a day, and on some days many more. The work goes on day and night, with three shifts of employees. Checks are received from the banks through a special station of the Post Office established in the reserve bank, and are then sorted, recorded, and sent on to their destinations, either other reserve banks, local clearing-houses, or individual banks, as the case may be. In spite of the great volume of checks handled, differences seldom amount to more than a few cents on a day's transactions.

With the establishment and operation of this collection system one of the major purposes of the Federal Reserve Act is fulfilled.

¹ January to May.

Mechanism of Expansion Under the Federal Reserve System.

*From the Monthly Review of the Federal Reserve Bank of New York
Sept., 1921, p. 12.*

Under the old National banking system in effect before the Federal Reserve Act, the gold and lawful money which the national banks held as reserves was in the proportion on the average of about \$1 of reserves to \$8 of loans and deposits. This power of expansion was in part the result of the ability of banks in the smaller cities and villages to keep a portion of their reserves with the city banks, where they were used as the basis for further expansion. Country banks were obliged to keep 15 per cent of their net deposits in reserve, of which three-fifths could be kept on deposit in reserve or central reserve cities, and banks in central reserve cities were required to keep a 25 per cent reserve, all of which was kept in their own vaults. Thus the same dollar of gold or lawful money might be used as reserve in three different banks, permitting an expansion greater than that implied in the average reserve requirements of the several individual banks.

In times of financial ease, when expansion was least needed, there was normally a tendency for this method of depositing and redepositing reserves to be carried to its limit. But as soon as financial stress was foreseen, when expansion was most needed, there was a tendency for the banks to draw their reserves on deposit into their own vaults, thereby reducing the power of expansion inherent in the pyramiding of reserves.

Under the Federal Reserve Act, which became effective on November 16, 1914, and the amendment to it of June 21, 1917, the unsound method of depositing and redepositing reserves in commercial banks came to an end. The entire reserves of all member banks were to be kept at the Federal reserve banks. This pooling of reserves at once made for greater safety and permitted somewhat smaller reserve requirements. Required reserves of country banks against net demand deposits were reduced to 7 per cent, of reserve city banks to 10 per cent, and of central reserve city banks to 13 per cent. The uniform reserve requirement on time deposits was reduced to 3 per cent. Whatever cash a member bank might find it necessary to keep in its vault for use as till money, amounting now to about 3 per cent, was not to count as reserve at all. This was a most important change in the law, because it had the effect of transferring to the reserve banks, where it might serve when necessary as the basis for credit expansion, practically all of the gold formerly held in the vaults of member banks.

The power of expansion implied in these reserve requirements should be considered in connection with the reserve requirements within the Federal reserve banks themselves. A Federal reserve bank is required to keep a minimum of 40 per cent of gold as reserve against Federal reserve notes, and a minimum of 35 per cent of gold, or lawful money, against deposits.

Gold, as far as the member banks are concerned, has no power of expansion until it is on deposit with a Federal reserve bank. Thus a deposit of \$100,000 of gold in a member bank merely counts as a deposit and is not susceptible of expansion until it is deposited in a Federal reserve bank, when, on the average, it will permit an increase of about \$1,150,000 in the loans and deposits of a member bank. The expansion would be very much greater than that, if it were not for the fact that a large part of the deposits created at a Federal reserve bank are drawn out again in the form of Federal reserve notes. While the statements of individual Federal reserve banks show considerable variation, the proportion of Federal reserve notes outstanding as compared with the deposited reserves of member banks is at present in the ratio of about three to two, which coincides with the average estimated by Professor W. M. Persons of Harvard. On the assumption, then, that \$3 out of every \$5 deposited with the Federal reserve bank is withdrawn in notes, \$100,000 of gold deposited in the Federal reserve bank would permit an average increase in the loans and deposits of member banks as follows:

For banks in central reserve cities	\$1,030,000
For banks in reserve cities	1,294,000
For country banks	1,786,000

The different degrees of expansion in the three classes of banks are explained in their varying reserve requirements. The following example assumes that a country bank is expanding to the maximum on \$100,000 of gold deposited in a Federal reserve bank.

For every \$5 of gold deposited by a member bank with a Federal Reserve Bank, \$3 is likely to be withdrawn in Federal Reserve notes and \$2 is likely to be used as reserve against the deposits of the member bank. The \$3 of gold will act as reserve against Federal Reserve notes amounting to \$ 7.50
(Because its 40 per cent reserve requirement permits an expansion of 2.5 times)

The \$2 of gold will act as reserve against the reserve deposits of member banks, amounting to \$5.72
(Because its 25 per cent reserve requirement permits an expansion of 2.36 times)

And that \$5.72 will act as reserve against deposits in a country member bank amounting to	81.80
(Because its 7 per cent reserve requirement permits an expansion of 14.3 times)	
Making a total of	\$89.30
Which multiplied by 20,000 (the number of times \$5 is contained in \$100,000) gives	\$1,786,000

It will be observed that the figures given above do not take into consideration the vault cash which a member bank may find it desirable to keep. Making allowance for that requirement, and averaging all banks in the country, the expansion works out at about 11.5 times.

In order for a member bank to enlarge its reserves at the reserve bank, it is not necessary for it to make a deposit of gold or lawful money, because a loan by a reserve bank to a member bank adds to the reserves of the latter in exactly the same way as though gold had been imported and deposited by that member bank; and it may use it as reserve against its own deposits or withdraw notes against it in just the same way. The determining factor as to how long such loans may go on is the stock of gold which the reserve bank has and which it uses as the basis for its own expansion.

The extent to which the reserve system's power of expansion is availed of varies, of course, with the credit needs and conditions of the country; growing when demands are great and diminishing when demands subside. Expansion and contraction of reserve credits are therefore the *result* of the increasing or decreasing demands of member banks, rather than a *cause* of the increase or decrease in the amount of loans made by member banks to their customers.

Retiring Excess Credit Under the Federal Reserve System.

From the Monthly Review of the Federal Reserve Bank of New York, Oct., 1921, p. 12.

In last month's Review the mechanism of expansion under the Federal reserve system was described. A description of the reverse process by which excess credit is retired will be of interest at this time.

Just as the increasing demands of a bank's customers for funds cause an increase of the loans and deposits of a bank and in turn of the loans, deposits and circulation of a Federal reserve bank, so the decreasing demands of a bank's customers for funds cause a decrease of a bank's loans and deposits and in turn of the loans, deposits and circulation of a Federal reserve bank. In other words, the first step in a reduction in the volume of credit, as in its expansion, is taken by a bank's customers; the

second step is taken by the banks themselves, and the third step is registered on the books of the reserve bank.

While an inspection of what has already taken place will give the clearest idea of the processes by which excess credit is retired, it should be understood, however, that our recent experience is probably not typical of what might be anticipated under normal conditions. The loans of the Federal reserve banks reached their highest point on October 15, 1920, the same date on which the loans of member banks in the principal cities throughout the country reached their maximum. A comparison of the principal items is as follows:

Resources.

(In million of dollars)

	October 15, 1920.	September 21, 1921.	Increase or Decrease.
Gold reserves	\$1,922	\$2,711	+ 719
Other reserves	163	152	— 11
Total earning assets	3,422	1,652	— 1,770
Uncollected items	998	592	— 406
All other resources	35	54	+ 19
Total Resources	\$6,610	\$5,161	— 1,449

Liabilities.

(In million of dollars)

	October 15, 1920.	September 21, 1921.	Increase or Decrease.
Member bank reserve deposits.....	\$1,868	\$1,588	— 280
Other deposits	48	103	+ 55
Deferred availability items	777	503	— 274
Federal Reserve notes in actual circulation	3,353	2,475	— 878
Federal Reserve bank notes in actual circulation	214	103	— 111
All other liabilities	350	389	+ 39
Total Liabilities	\$6,610	\$5,161	— 1,449

In the following summary, the reserve bank credits which were retired have been grouped so as to include earning assets—that is, the loans made by reserve banks to member banks, the bankers acceptances held by the reserve banks and the Government securities held by them—collection items, such as checks in process of collection, Federal reserve notes and bank notes held by reserve banks other than those which issued them, together with national bank notes held by Federal reserve banks; and a small amount of miscellaneous assets. The means by which the retirement of reserve bank credits was accomplished have been grouped to

include the increase of reserves, the decrease of deposits, and the decrease in Federal reserve note and bank note circulation. The period covered is from October 15, 1920, to September 21, 1921.

Retirement of Reserve Bank Credits:

1. DECREASED EARNING ASSETS.

Member banks reduced their discounts and advances at the	
Reserve Banks	\$1,387,000,000
The Reserve Banks held less acceptances	286,000,000
The Reserve Banks held less Government securities.....	97,000,000

2. DECREASED COLLECTION ITEMS.

The Reserve Banks had a smaller net amount of items in process of collection	
	132,000,000

3. DECREASED MISCELLANEOUS ASSETS.

The Reserve Banks had a smaller net amount of miscellaneous assets	
	20,000,000

Total	\$1,922,000,000
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The Means of Retirement:

1. INCREASED RESERVES.

The Reserve Banks received from member banks and other sources additional gold which caused a net increase in reserves	
	\$708,000,000

2. DECREASED CIRCULATION.

The member banks in paying loans at the Reserve Banks used \$878,000,000 surplus Federal Reserve notes and \$111,000,000 Federal Reserve bank notes	
	989,000,000

3. DECREASED DEPOSITS.

The member banks, in paying loans, used excess deposits at the Reserve Banks of \$280,000,000, which, with an increase in other deposits, caused a net reduction of.....	
	225,000,000

Total	\$1,922,000,000
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The element which distinguishes the present period from others in the experience of this country, and possibly from corresponding periods in the future, is the increase in gold reserve. Since October 15, 1920, gold importations have amounted to \$696,000,000, of which all but \$4,000,000 has been incorporated in the reserves of the Federal reserve banks. The effect of this large increase in gold reserves has been to increase rapidly the reserve ratio of the Federal reserve system. Inasmuch as the retirement of Federal reserve notes releases as free gold only 40 per cent of the amount retired, and inasmuch as the decline in deposits at the reserve banks releases only 35 per cent of their amount in gold, the introduction of gold directly into the reserves of the Federal

reserve banks is more than twice as effective as the retirement of notes or deposits. If there had been no gold accessions since October, 1920, the reserve percentage of the Federal Reserve System would now be 52 per cent instead of 68.7 per cent.

Member banks were able to reduce their deposits at the reserve banks \$280,000,000 because their own deposits were reduced. That reduction served to improve the position of the reserve banks to the same extent as importing \$98,000,000 of gold—not much more than was received in the single month of August. But inasmuch as member banks keep on the average about 10 per cent of their deposits with the reserve banks, that reduction implies a decline of about \$2,800,000,000 in their own deposits, and a corresponding decline of about \$2,800,000,000 in their loans to customers.

Had the increase registered in the reserve position of the Federal reserve banks been based entirely upon liquidation by customers of member banks, it would have presupposed a contraction in the business of the country of the most serious and far-reaching consequences.

Security Behind Federal Reserve Notes.

From the Monthly Review of the Federal Reserve Bank of New York, April, 1922, p. 12.

People here and abroad are thinking about the security behind the paper money which passes from hand to hand in the course of trade, and especially how that security affects the character and usefulness of paper money. The kind of security is most important because if it is unsound, the paper money based upon it is likely to have a diminishing power to buy goods, and if it is available in an amount not readily increased or decreased, the paper money so secured is apt to induce periods of distress such as that of 1907 in this country. Soundness and elasticity are two qualities essential in a nation's currency, especially in a country like this where the demands for currency vary greatly from one season to another and from one year to another.

In this country various proposals have been advanced recently looking to a change in the kind of security behind our paper currency. Some of the proposals appear to have been based on incomplete knowledge of what the security behind our various forms of paper currency already consists of, particularly the security behind Federal reserve notes. These now form about 50 per cent of the paper currency in circulation in this country. They are the most important part, because they are the only form of currency we have which increases and decreases automatically in response to the needs of industry, commerce and agriculture.

Prior to the establishment of the Federal Reserve System we had in general use four kinds of paper money, all of which are still issued. First, gold certificates, secured dollar for dollar by gold held in the Treasury of the United States, and susceptible of being increased or decreased only as the volume of gold in the Treasury was increased or decreased. Second, silver certificates, secured dollar for dollar by coined silver, the amount of which is limited by law. Third, legal tender notes, the greenbacks of the Civil War, but through successive steps taken by the Treasury for many years, secured by gold to the amount of about 50 per cent of the total in circulation. The amount of these in circulation also is limited by statute. Fourth, national bank notes, issued by the National banks of the country and secured by United States Government bonds, which bear low rates of interest but carry the privilege to the bank holding them of issuing currency. For purposes of redemption each National bank is obliged to maintain a fund of lawful money in Washington amounting to 5 per cent of its notes in circulation.

It will be noted that though these various kinds of paper currency are interchangeable dollar for dollar one with another, the security behind them is in some cases 100 per cent metallic and in other cases mainly Government obligations; also that the amount of the total circulation was so rigid that it could neither be readily decreased to suit the needs of slack seasons and dull years, nor be readily increased to meet the requirements of busy seasons and periods of emergency.

The Federal Reserve Act in prescribing the security behind Federal reserve notes introduced a new principle into our currency system. It specifies a security which is sound and at the same time increases and decreases automatically with the business and agricultural needs of the country. This security may be partly gold and partly borrowers' paper, very shortly to be paid. Such paper gives to Federal reserve notes their distinctive character, and insures their responsiveness to the needs of the country for currency.

Apart from notes secured by obligations of the Government, which have become widely available on account of the large issues of bonds and notes to finance the war, this paper represents agricultural products or other goods in the process of production or in movement from producer to retailer, in process of export or import, or on the shelves of retailer or wholesaler awaiting sale. The paper must bear the indorsement of a member bank and its maximum maturity is ninety days, except in the case of agricultural paper which may run for six months. In actual practice the maturity is shorter, averaging in recent months about fifteen days. In practice also it has been customary to hold paper of this type in sufficient volume to bring the total amount of the security

held against Federal reserve notes to considerably more than 100 per cent of their full face value as the law requires

In recent months the gold holdings of the Federal reserve banks have been so largely increased and the amount of notes outstanding so reduced that Federal reserve notes have come to be secured almost dollar for dollar in gold, but at times of greater credit and currency expansion and in periods of smaller gold holdings, the amounts of commercial paper have been a substantially larger portion of the total security. Thus the *kind* of security behind Federal reserve notes is elastic.

Commercial, industrial and agricultural paper of this type has exceptional advantages as security for note circulation. In the first place, the currency is placed upon an absolutely safe basis. Back of the paper, a large part of which matures and is paid every day, are immediately salable goods or other assets which may be realized upon rapidly. Moreover, the reserve of gold maintained against Federal reserve notes must at all times be equal at least to 40 per cent of the total amount of notes in circulation.

In the second place, the currency is immediately related and responsive to the needs of business. When business expands and the movement of goods increases, the amount of paper available as collateral security for Federal reserve notes is increased. The demand on the banks for currency leads to the presentation of this paper at the Federal reserve banks and the issue of notes. Similarly, when the volume of business diminishes, currency is returned to the banks in payment of loans and the banks in turn ship currency to the reserve banks to liquidate borrowings. Thus the *quantity* of Federal reserve notes is elastic.

In these ways Federal reserve notes meet two main conditions of a useful currency, soundness and elasticity; and the elasticity is both in the *kind* of security behind them, and in the *quantity* of notes that may be issued.

Replacing Worn Currency Through the Reserve Banks.

From the Monthly Review of the Federal Reserve Bank of New York, Aug., 1922, p. 12.

There is at present about \$4,500,000 of currency in circulation in the United States. While a considerable part of it at any given moment is in the safes of individuals, business concerns, or banks, yet much of it is in peoples' pockets or in process of passing from hand to hand, and so is subject to wear. In this country paper money, which forms about four-fifths of our whole supply of currency, is generally preferred above coin because of its lightness and convenience. But paper money wears out

rapidly and has to be replaced frequently. The life of a five-dollar note, for example, is on the average about ten months, and in New York City is about two months less than the average, owing mainly to the more rapid rate at which it circulates. This same tendency is seen in the higher rate at which bank deposits turn over in New York City than in other parts of the country.

The work of keeping the paper currency in good condition is done very largely by the Federal reserve banks, which in the course of their daily business handle all forms of currency and coin, eliminating that which is unfit for further circulation. This service is a large item in their annual costs of operation. Last year, for instance, the supply of currency and coin caused an expenditure at the Federal Reserve Bank of New York amounting to about \$2,875,000, of which somewhat more than one-third represented the cost of printing new Federal reserve currency to replace worn notes in circulation and to increase supplies unissued and on hand.

The Process of Replacement.

The process of replacement ordinarily works in about this way: When a man has a worn-out bill—whether it be a Federal reserve note, a Federal reserve bank note, a legal tender note, a silver or gold certificate, or a national bank note—he takes it to his bank and receives in return for it a note fit for circulation; or, if he wishes, obtains credit for it in his deposit account. Banks which are members of the Federal Reserve System ordinarily do not keep more currency on hand than they are likely to need for the day-to-day use of their customers. Accordingly, shipments of currency are constantly passing between member banks and their Federal reserve banks, and notes unfit for further circulation are usually sent along with shipments of currency, which for the time being may be in excess of requirements. Such a shipment the Federal reserve bank places to the credit of the transmitting member bank in its deposit account for use as the member bank desires. A non-member bank may also ship notes directly to the Federal reserve bank, receiving payment by draft, or by deposit to its account in its correspondent bank, or in currency as is described below.

Currency received by the Federal reserve banks in these ways is first counted and is then sorted according to denomination and kind, and mutilated and badly worn currency is eliminated. All Federal reserve notes fit for circulation issued by reserve banks other than the one handling them are shipped immediately to the respective issuing banks, inasmuch as no reserve bank is permitted under the law to pay out notes of another Federal reserve bank. Notes of other types which are fit for

use are held in the vaults until needed, and all notes which are unfit for further circulation are canceled and shipped to Washington for redemption.

Issue of New Money.

Currency is supplied to banks, both member and non-member, in amounts and denominations as they desire. Since much currency fit for further circulation is returned to the reserve banks, all shipments of currency cannot be made in new money, the supply of which is apportioned to the banks according to the volume of their business. A member bank draws currency from the Federal reserve bank in just the same way that an individual draws currency from his own bank, and such withdrawals are charged to its deposit account. The bank which is not a member of the Federal Reserve System usually pays for a shipment of currency either by check or by sending in unfit currency. At the New York reserve bank a supply of approximately \$500,000,000 in paper currency is kept on hand for use when needed, and about as much more currency is available in Washington.

The Volume of Money Handled.

The volume of currency handled each year by the Federal reserve banks reaches in aggregate a very large figure. In 1921 all twelve Federal reserve banks received from member and non-member banks \$7,750,000,000 in paper money and coin. Payments to banks amounted to \$6,490,000,000, and as a net result more than \$1,000,000,000 in paper money and coin was retired from circulation, illustrating the lessened demand on the part of the public for hand-to-hand currency. The share of this work handled in 1921 by the New York reserve bank will appear in the following:

About 687,000,000 individual notes were counted.

About 166,000,000 notes aggregating \$771,000,000 were canceled.

There were 175,000 different shipments of currency and coin to and from out-of-town banks.

In carrying forward these operations the Federal reserve banks now do much work which the Government formerly performed through the Subtreasuries. On May 29, 1920, an Act of Congress was approved providing for the discontinuance of the subtreasury system, which was established in 1846, and the transfer of its currency functions to the Federal reserve banks. Although this transfer of functions brought about some increase in the cost of carrying on the currency operations of the reserve banks, the total cost of maintaining the country's currency was substantially reduced.

Federal Reserve Banks as Banking Agents for the Government.

From the Monthly Review of the Federal Reserve Bank of New York, September, 1922, p. 12.

The largest business organization in this country is the United States Government. To meet its annual expenditures it collects in revenue, or borrows through sale of securities, sums vastly greater than any ever approached by a private corporation. Until recently, however, there has been no country-wide organization to handle these operations.

The Independent Treasury.

The first and second United States Banks, which represented an attempt to handle Government funds through one central Federal bank, succumbed to opposition of the State banks and a belief that they were undemocratic. So insecure, however, were Government deposits in the then badly managed State banks that the Government in 1846 created the Subtreasury System, or the so-called Independent Treasury, which was designed to carry on all Government financial operations completely independent of the banks of the country.

During the Civil War, and afterward, the Government found increasing need for closer co-operation with the banks for distributing its securities and other purposes. Moreover the custom of locking up funds in the Treasury vaults for indefinite periods often resulted in a serious shortage of funds for the conduct of the country's business. Certain funds were allowed to accumulate in depository banks but there was no satisfactory system of distributing the funds among the banks.

Bankers for the Government.

One of the objects of the Federal Reserve Act was to provide the Government with a suitable banking agent. Under the terms of the Act, on November 23, 1915, the Federal reserve banks were officially appointed fiscal agents of the Government by the Secretary of the Treasury, and were empowered to accept Government receipts, carry Government deposits, and pay checks and warrants drawn by the Treasurer of the United States, as well as coupons on the Government debt.

To these types of service the reserve banks are by the nature of their organization peculiarly adapted. Any Government check, no matter where drawn, will be paid at any of the 12 reserve banks or their 23 branches, thus providing a convenient and prompt means of payment. The breadth of the reserve bank facilities is similarly convenient for the handling of Treasury notes and certificates of indebtedness, which

may be redeemed at any reserve bank regardless of where they were sold. The private telegraph system maintained by the reserve banks by which funds can be transferred instantly to and from different sections of the country has also proved absolutely essential to the Government's immense operations during and since the World War.

Meeting Government War Needs.

The outbreak of the war resulted not only in a vast expansion in the operations of the reserve banks as bankers to the Government, but in the assumption of responsibilities, unprecedented in both character and volume, in effecting the flotation and distribution of Government war securities. As administrative centers of the Liberty Loan committees, they were the heart of the greatest bond selling organizations ever created. They advertised the bonds, handled the subscriptions and payments, distributed the bonds, and kept the accounts of five bond issues aggregating \$21,000,000,000 with more than 63,000,000 subscriptions. Just as currency requires changing from one denomination to another, so these issues of Liberty bonds and Victory notes require changing not only from one denomination to another, but also from one issue to another, from registered to unregistered or vice versa, from temporary to permanent. These operations were undertaken by the reserve banks and are still being carried forward. Interest payments are made through the reserve banks and Victory notes as they mature are being redeemed.

The reserve banks have also assumed charge of the sale and redemption in their respective districts of the successive issues of Treasury certificates of indebtedness by means of which the Government supplied its current needs in intervals between the flotation of Liberty Loans and now maintains its floating indebtedness. In all, from the first certificate issue in 1917 to the most recent certificate and short note issues in the refunding program of the Treasury, the reserve banks acted as agents for the distribution of \$36,000,000,000 short-term Government issues, and for the redemption of \$32,000,000,000. To avoid disturbance to the money market, funds obtained by the Government from sales of all such issues are permitted to remain in the banks as Government deposits until required, secured by collateral pledged with the reserve banks.

Size of Operations.

Some idea of the size of these operations may be gathered from the following figures for the year 1921 for the Federal Reserve Bank of New York alone:

Government checks handled	\$1,638,000,000
Government bonds transferred by telegraph	\$1,220,000,000
Government bonds and notes handled for conversion or exchange	\$5,639,000,000
Certificates of indebtedness and short term notes sold	\$1,481,000,000
Number of employees in fiscal agency departments	264

The cost of fiscal agency operations of the reserve banks up to July 1, 1921, was reimbursed by the Government, but since that date all expenses, except a few incidentals, have been borne by the reserve banks. From July 1 to December 31, 1921, the services performed for the Government by the Federal Reserve Bank of New York, solely in connection with the handling of Government loans cost \$572,748.

With the continuous enlargement of the fiscal agency operations of the reserve banks, the necessity for maintaining the Subtreasuries was reduced correspondingly. By Act of Congress, approved May 29, 1920, their discontinuance was authorized, and early in the ensuing year the reserve banks formally took over all their functions except the keeping of the metallic reserve behind gold and silver certificates and United States notes, which was transferred to the Treasury at Washington.

The closing of the Subtreasuries marks the final passing of the Independent Treasury and its replacement by the reserve banks. In place of an expensive, cumbersome, inelastic system for handling public funds almost entirely unrelated to the business life of the country, the reserve banks provide practically without cost to the Government, a flexible organization immediately related to the banking and business life of the entire country.

The Relation of Gold Movements to the Reserve Banks.

From the Monthly Review of the Federal Reserve Bank of New York, October, 1922, p. 12.

The inflow of over a billion dollars of gold in the past two years, and the receipt of a similar amount in the two years just preceding America's entry into the war, are the two greatest gold movements in history. Just how such additions to our gold supply act upon the volume of credit, now that the Federal Reserve System is in existence, is not clearly understood. It may be made clearer if we review briefly four periods.

I. Before the Reserve System.

Before the Federal Reserve System, when gold flowed into the United States, it found its way into banks, increased the proportion of gold to deposits, and as the banks kept as legal reserve only a certain portion of their deposits in gold, permitted them to increase their deposits by an

amount several times the amount of the gold imported. This increase in deposits was mainly brought about by increasing loans. Large amounts of gold usually stimulated business activity and a rise in commodity prices. Conversely, an outflow of gold usually produced the opposite result, and reduced loans and deposits several times the amount of the gold exported.

II. The Gold Inflow of January, 1915, to April, 1917.

The Federal Reserve System was established in November, 1914, and until June, 1917, member banks, while keeping a substantial part of their gold with the reserve banks, were required by law to carry considerable gold in their vaults. Furthermore, but few of the State institutions, which represent about one-half the banking resources of the country, were at that time members of the system and they were carrying gold reserves just as before the system began. From January, 1915, to April, 1917, when America entered the war, more than a billion dollars of gold flowed in, representing payment for urgent purchases by belligerent nations which were unable either to ship goods in payment for ours, or to obtain credits here in sufficient amounts. These purchases introduced the element of competitive bidding for the goods required. Part of the gold went into circulation and the rest went into the vaults of the banks, where it increased their reserves, enabled them greatly to increase their deposits and loans, and created just such a situation as under similar conditions it would have created before the Federal Reserve System; that is, credit volume rising, prices rising, and intense business activity. But there was not a large or in any degree corresponding increase in the volume of goods produced.

The Federal Reserve System, only recently established, and having but a small volume of loans and investments through the repayment of which the effect of the imported gold might have been offset, was in no position to exert any influence upon these conditions.

III. The War Period: April, 1917—August, 1920.

Promptly upon America's entry into the war gold ceased to flow in, as our credit became available to our allies. And an embargo was placed on the outflow of gold. Immediately the credit needs of our Government began greatly to exceed the current savings of the people. Between April, 1917, and August, 1920, without any increase in our gold supply, exactly the same economic phenomena occurred as in the two preceding years of heavy gold inflow. The Federal Reserve System, whose credit power, owing to the inflow of gold, had hitherto lain dormant, was

called upon to provide the additional bank reserves and the hand-to-hand currency required by the credit and price expansion of the war period. The use of Federal reserve credit for this purpose culminated in October and November, 1920, after several months of credit strain during which the Federal reserve reservoir was drawn down almost to the legal limit—a strain which was accentuated by a net outflow of about \$400,000,000 of gold between June, 1919, and August, 1920.

A comparison of these two periods of credit and price expansion under war pressure, one based on gold imports, and the other on the use of Federal reserve credit, shows that the additional credit or lending power derived from the two sources was practically identical in its effect on the general credit and price structure. In both instances the banks were provided with the additional reserves and hand-to-hand currency required for a general expansion of bank deposits and loans; and it is well known that if such expansion is not paralleled by a corresponding expansion in the production of goods, a rise in commodity prices usually results.

IV. The Second Gold Inflow: Since August, 1920.

In the period from August, 1920, to the present, another great movement of gold, nearly equal to that of 1915–1917, has occurred, but under very different industrial conditions. Imperative buying and borrowing by governments had ceased; and in the early part of the period prices were falling, business was depressed. Three and a half billions of Federal reserve credit had been extended, and the banks were heavily in debt to the reserve banks. In the past two years, accordingly, the billion of gold which came in was deposited as usual with the member banks, and turned over by them to the reserve banks. But instead of using the fresh reserves thus created as a basis for further expansion, the member banks took advantage of them, after the strain of 1920 was over, to pay off their indebtedness to the Federal Reserve System. Thus, broadly speaking, when this second inflow of gold occurred, conditions were unfavorable to its use in further expansion, and it actually helped liquidate the expansion of the preceding period.

It will be seen from the analysis of these four periods that whether or not the Federal Reserve System is able to absorb an inflow of gold of such dimensions as those of the second and fourth periods depends largely upon whether, at the time, it has a large volume of loans and investments which, if conditions are favorable to such a course, will be repaid with the new gold so received. The less loans and investments of the system are in a period of gold inflow the less its influence will be upon the conditions produced by the added gold.

It should also be understood that the expansion of credit from the inflow of gold, as above discussed, is that primary and somewhat automatic expansion resulting from the direct increase of member and other bank reserves which the gold creates, in an amount several times as great as the amount of the gold itself. The discussion has not touched upon the further expansion which the same gold may support after it reaches the reserve banks, should member banks have occasion, as in the third period, to borrow heavily from reserve banks.

Membership in the Federal Reserve System.

From the Monthly Review of the Federal Reserve Bank of New York, November, 1922, p. 12.

The members of the Federal Reserve System comprise about 10,000 National and State banks and trust companies—approximately one-third of all the banks in the country. This proportion of about one-third does not hold uniformly in all the States, but varies from about ten per cent in some States to upward of seventy per cent in others. In point of resources, the member banks represent about two-thirds of the banking strength of the country.

What Banks Are Members.

Under the Federal Reserve Act all National banks are members of the Federal Reserve System; and State banks and trust companies may apply for admission. State institutions may also withdraw from the system. The following table shows the number of member banks, both National and State, and their resources on June 30th of each year since 1915.

Year as of June 30	NUMBER OF BANKS			RESOURCES. (In millions)		
	National	State	Total	National	State	Total
1915	7,598	17	7,615	11,790	97	11,887
1916	7,572	34	7,606	13,920	307	14,227
1917	7,600	53	7,653	16,282	756	17,038
1918	7,700	513	8,213	18,347	6,104	24,451
1919	7,780	1,042	8,822	21,228	8,628	29,856
1920	8,025	1,374	9,399	23,402	10,351	33,753
1921	8,150	1,595	9,745	20,510	10,426	30,936
1922	8,244	1,648	9,892	20,698	11,026	31,724

State institutions applying for membership are required to have at least the minimum paid-up capital required of newly established National banks. For example, the minimum capital required of a National bank established in a rural community is \$25,000, and State banks having a

capital of less than that are not now eligible for membership. In many agricultural States a very large number of rural banks having small capital are ineligible for membership and so are without direct access to the Federal reserve banks. The number of ineligible State banks is about 10,000.

In all cases State institutions applying for membership are subject to examination by the Federal reserve bank before admission, so that their condition and banking policies may be ascertained.

What Membership Means.

A member bank must subscribe for stock in its Federal reserve bank in the amount of 6 per cent of its own capital and surplus; and as a member bank's capital and surplus increase, it must increase its ownership of stock in the Federal reserve bank. The member banks are the sole owners of reserve bank stock. This stock is not transferable and so cannot be sold, thus preventing a concentration of control of the Federal reserve banks. If a bank liquidates or retires from the system, the shares held by it are canceled, and the bank receives back what it paid in. Thus far the member banks have been called upon to pay in only 50 per cent of the amount of stock subscribed for. Dividends have been paid at the rate of 6 per cent annually upon the amount paid in.

A member bank keeps all of its reserves with the reserve bank. These reserves form almost the entire volume of deposits which reserve banks have. They are in a fixed proportion to the amount of deposits which the member banks have—on the average, 10 per cent.

To all member banks are available the various services provided by the Federal reserve banks. These services, which have been described individually from time to time in the Review, include the making of loans, the supply of currency, the collection of checks, the transfer of funds by wire, and other services.

Membership in Various States.

The variation among the different States in the proportion that member banks bear to the total number of banks, appears in the following table. It shows also the proportion that the resources of member banks bear to the total banking resources of each State. For convenience, the sum of the deposits, capital, surplus and undivided profits is taken to reflect the resources of banks. The percentages are based upon figures

taken from the report of the Comptroller of the Currency, and show the condition as of June 30, 1921.

State.	Per cent of member banks to total.	Per cent of member resources to total.	State.	Per cent of member banks to total.	Per cent of member resources to total.
Maine	55	54	Ohio	46	72
New Hampshire	69	60	Indiana	30	47
Vermont	56	41	Illinois	30	65
Massachusetts	7	82	Michigan	40	77
Rhode Island	61	82	Wisconsin	19	52
Connecticut	51	60	Minnesota	24	56
			Iowa	27	40
			Missouri	10	56
Total—New Eng- land States	<u>62</u>	<u>74</u>	Total—Middle Western States ..	<u>27</u>	<u>62</u>
New York	72	86	North Dakota	22	41
New Jersey	70	69	South Dakota	22	37
Pennsylvania	62	68	Nebraska	17	41
Delaware	42	60	Kansas	20	38
Maryland	36	52	Montana	49	71
Washington, D. C. ...	34	50	Wyoming	33	67
			Colorado	37	71
Total—Eastern States	<u>63</u>	<u>78</u>	New Mexico	45	64
			Oklahoma	39	64
Virginia	37	68	Total—Western States	<u>27</u>	<u>51</u>
West Virginia	38	50			
North Carolina	16	49	Washington	38	69
South Carolina	22	47	Oregon	45	72
Georgia	23	59	California	49	67
Florida	25	57	Idaho	60	73
Alabama	35	70	Utah	50	69
Mississippi	10	27	Nevada	31	38
Louisiana	19	64	Arizona	30	40
Texas	47	77			
Arkansas	24	60	Total—Pacific States	<u>46</u>	<u>67</u>
Kentucky	24	55			
Tennessee	20	57	Grand Total	<u>33</u>	<u>68</u>
Total—Southern States	<u>29</u>	<u>60</u>			

It will be seen that in general the highest proportion of membership and of member bank resources is in the northeastern States.

The Development of Par Collections by Federal Reserve Banks.

Letter No. 6, May, 1922.

As we have already seen, prior to 1919 the Federal reserve banks of Boston and New York had placed all the banks in their districts on the par list. That is to say, they had established and maintained their ability to collect from all banks in their two districts without the payment of exchange. This, as we have intimated, was done partly by explanation and persuasion, but toward the end, in the case of the New York district (and possibly also that of the Boston district), the last few banks were brought over by the use of the express companies in making collections. As a matter of course, when checks are presented for payment by an express agent the checks must be paid in money. If the express agent should accept the bank's draft on any other bank and that draft should prove uncollectible, the express company would have to make good the amount. In the early part of 1919 all the Federal reserve districts (except, of course, those of Boston and New York) bent their efforts to the placing of one or more whole States in each district upon the par list. Various plans of campaign were followed in each district but the principles of these campaigns were practically the same in all districts. We can, therefore, illustrate the matter by showing in some detail what was done in the Richmond district. In doing this we will not confine ourselves to the year 1919 but with respect to this phase of the subject we will follow through to the present date.

The Fifth Federal Reserve District is composed of the District of Columbia and five States—Maryland, West Virginia (except a very small portion in the northern part of the State), Virginia, North Carolina, and South Carolina.

In the District of Columbia, which is small and compact, collections at par on all banks, member and non-member, were possible from the beginning of the present collection system.

In Maryland, while many of the non-member banks agreed to remit at par, there were still a few that held out for exchange. The banks in the city of Baltimore had established a country clearing house for the collection of checks drawn upon certain Maryland banks located outside of the city of Baltimore, but this number embraced only those upon which collections could be made at par. When the Baltimore branch of the Federal Reserve Bank of Richmond was established on March 1, 1918, this country clearing house was taken over and subsequently many, but not all, of the non-member banks in Maryland were added to the par list. By September 1, 1919, the number of non-par banks in Maryland had been reduced to a small number. As we have already stated,

this was done by correspondence and by personal visits of representatives from the Federal Reserve Bank of Richmond and the Baltimore branch who explained the objects and advantages of the par collection plan to the non-member banks.

The Federal Reserve Bank of Richmond notified all its member banks and other Federal reserve banks that on and after September 10, 1919, checks on all banks in the State of Maryland would be received for collection and that credit at par would be given in accordance with the published time schedule. On September 10, 1919, all the non-member banks in Maryland except five had been added to the par list. The five remaining banks were notified that checks drawn upon them and sent to the Federal Reserve Bank of Richmond (or to the Baltimore branch) would be sent to them in due course for remittance at par, and they were requested to remit immediately upon receipt of such checks without the deduction of exchange or to return the checks unpaid. They were also notified that in case of their refusal or failure to remit at par the checks would be presented by a representative of the Federal Reserve Bank of Richmond who would demand payment in money. They were advised, moreover, that unless and until they agreed to remit by mail at par, arrangements would be made for the daily presentation of all checks drawn upon them and sent for collection through the Federal Reserve System and that only money would be accepted in payment. As a matter of fact only two banks in Maryland refused to remit at par and in only one case was it necessary to make actual presentation of checks. In that case only one presentation was made. As a matter of course, on and after September 10, 1919, the State of Maryland appeared on the par list of the Federal Reserve System as a whole-par State.

Some time after the establishment of the Baltimore branch of the Federal Reserve Bank of Richmond a part of the State of West Virginia was assigned to the branch, the remainder being still within the territory of the parent bank at Richmond. The reason for this assignment of a part of West Virginia to the Baltimore branch that was owing to railroad facilities and mail schedules it is possible for that part of the State to reach Baltimore in less time than is required for it to reach Richmond. All the banks in the territory transferred to the Baltimore branch consented to the transfer because in all cases equal facilities were possible and in most cases slightly better facilities were obtained.

During the latter part of 1919 and the early part of 1920 representatives of the Baltimore branch and representatives of the home office at Richmond, Virginia, canvassed the State of West Virginia in the interests of the par campaign. During this campaign it developed that many of

the non-member banks were willing to go on the par list if their neighbors who were in immediate competition with them would take the same course. We, therefore, adopted a plan of asking the non-member banks in West Virginia to sign an agreement to remit at par on and after any date upon which we were able to announce that we were prepared to collect checks on all banks in the entire State.

February 1, 1920, was the date finally fixed upon and on that date 59 non-member banks were added to the par list. In only eight cases was it necessary to make personal presentation of the checks and to demand money in payment. In some of these cases more than one demand had to be made but in a comparatively short time the eight banks agreed to remit at par. Since February 1, 1920, West Virginia has appeared on the par list as a whole-par State.

During the early part of 1920 a special canvass was made among the non-member banks in the State of Virginia that had not already agreed to remit at par. The procedure already outlined was followed and April 1, 1920, was named as the date on and after which the Federal Reserve Bank of Richmond would undertake to collect checks upon all banks, bankers, and trust companies in the State of Virginia. On April 1, 1920, 203 Virginia non-member banks were added to the par list. In 24 cases personal presentation of checks had to be made, sometimes once, sometimes oftener, but no such presentations have been necessary for a considerable time. Since April 1, 1920, Virginia has appeared on the par list as a whole-par State.

During the latter part of 1920 a similar campaign was conducted in North Carolina. November 15, 1920, was named as the date on and after which checks would be collected on all North Carolina banks and trust companies. On that date 478 banks were added to the par list and in 24 cases personal presentation had to be resorted to. One presentation was sufficient in some cases while in others several had to be made before the banks would agree to remit by mail at par. North Carolina remained an all-par State until the early part of 1921.

On February 5, 1921, the Legislature of North Carolina passed a special act, the object of which was to prevent the Federal reserve banks from collecting from State banks in North Carolina without the payment of exchange. Shortly after the act was passed a number of North Carolina banks brought suit against the Federal Reserve Bank of Richmond and obtained an injunction which prevented the collection of checks drawn upon non-member banks in North Carolina that were originally, or that became from time to time, parties to the suit. The history of this case will be given in more detail when we take up that aspect of the subject.

In August, 1919, a special map of the United States was published and circulated showing the progress of the campaign for par points. This map was divided by heavy black lines to indicate the boundaries of Federal reserve districts and the States were printed in three different colors. The States that were all-par were printed in red; the States that were nearly all-par, in pink; and the States in which the non-member, non-par banks were considerable in number were printed in green. Several of these maps were issued from time to time and on September 1, 1919, the Federal Reserve Board began the regular publication of such maps in black and white, one map appearing in each issue of the Federal Reserve Bulletin.

In these maps the United States was not divided into Federal reserve districts but only into States. All-par States were shown in white and the other States shaded by small diagonal lines. In each "shaded" State the number of non-par banks was printed. The map dated September 1, 1919, shows the following States all-par: Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut, New Jersey, Delaware, New York, Pennsylvania, Idaho, Nevada, and Utah. The map dated October 1, 1919, showed the same States with the addition of Maryland, Ohio, Kansas, and Wyoming. In this map the total number of banks in each State was shown, in one figure in the white States and in two in the shaded States. Where two figures were shown the upper figure indicated the total number of banks on the par list and the lower figure the total number of non-par banks in the State. Each succeeding map showed additional white States and the top figures in the shaded States in many instances indicated substantial gains.

A special map in two colors was issued by the Federal Reserve Bank of San Francisco soon after the first of January, 1920, in which two maps were shown, one as of January 1, 1919, and the other as of January 1, 1920. In the first map only the upper right-hand corner of the United States shows as all-par. In the second, the whole map indicates par States except Washington and Oregon in the Northwest; Arizona in the Southwest; South Dakota, Minnesota, and Wisconsin in the North-Central part; and practically all of the Southeast, including the Fifth and Sixth districts and part of the Eighth. The comparative figures of January 1, 1919, and January 1, 1920, have already been given and indicate an addition of 6,581 banks to the par list during the year 1919.

In its Sixth Annual Report (for the year 1919) the Federal Reserve Board, after commenting upon the progress made during the year and referring to the fact that it had been found necessary to adopt in many cases means of collecting other than through banks and referring to the

opposition which had arisen in many quarters to the course pursued by the Federal reserve banks, defined its position with regard to the par collection system and the methods pursued by the Federal reserve banks as follows:

The Board's action is based upon its conception of the very evident purposes of the Federal Reserve Act. Section 13 of the act begins as follows: "Any Federal reserve bank may receive from any of its member banks and from the United States, deposits of current funds in lawful money, national bank notes, Federal reserve notes, or checks, and drafts, payable upon presentation, and also, for collection, maturing notes and bills." Even though the Federal Reserve Board has heretofore ruled that the permissive "may" as used in the foregoing paragraph should not be construed to mean the mandatory "shall," nevertheless it is clear that a Federal reserve bank in order to do any business whatever must exercise some of the permissive powers authorized by law. It would be impossible otherwise for a Federal reserve bank to afford to its member banks many of the privileges which the law clearly contemplates and to which the member banks are clearly entitled. But independently of a discussion of this phase of the situation, it seems to the Board that doubts upon this question are resolved upon a consideration of the provisions of section 16: "Every Federal reserve bank shall receive on deposit at par from member banks or from Federal reserve banks checks and drafts drawn upon any of its depositors." In this case, the obligatory "shall" is used so that there is no option in the Federal reserve bank so far as checks and drafts upon its depositors are concerned. From this it may be argued that as the depositors of a Federal reserve bank are member banks there is no obligation upon the Federal reserve bank to receive on deposit at par checks on non-member banks, but even if the language of section 13 be construed as permissive there seems to be no question that the Federal reserve bank has the right to receive on deposit from any of its member banks any checks or drafts upon whomsoever drawn, provided they are payable upon presentation. The whole purpose of the act demands that in justice to member banks they should exercise that right.

Section 16 further provides that the Federal Reserve Board "may at its discretion exercise the functions of a clearing house for such Federal reserve banks . . . and may also require each such bank to exercise the functions of a clearing house for its member banks." In accordance with the purpose of this paragraph, the Federal Reserve Board, with the view ultimately of establishing a universal or national system of clearing intersectional balances as well as bank checks and drafts, has established a gold settlement fund through which daily clearings between all Federal reserve banks are consummated and has also required each Federal reserve bank to exercise the functions of a clearing house for its member banks. In order, however, to make fully effective its facilities as a clearing house in accordance with the terms of this section, there does not seem to be any doubt that the Federal reserve bank should not only exercise its obligatory power to receive from member banks checks and drafts drawn upon other member banks, but that it should also exercise its permissive power to receive from member banks any other checks and drafts upon whomsoever drawn, provided that they are payable upon presentation.

There are no doubt many non-member banks without sufficient capitalization to make them eligible for membership in the Federal Reserve System, but provision is made for such banks in section 13 by authorizing the Federal reserve banks, for purposes of exchange or of collection, to receive deposits from any non-member bank or trust company. But for the fact that the small country banks are able to have their out of town items credited at par by some city

correspondent, there is no doubt that many more of them would avail themselves of the non-member collection privilege than have done so.

There is a proviso in section 13 which allows member and non-member banks to make reasonable charges "to be determined and regulated by the Federal Reserve Board, but in no case to exceed 10 cents per \$100 or fraction thereof, based on the total of checks and drafts presented at any one time, for collection or payment of checks and drafts and remission thereof by exchange or otherwise; but no such charges shall be made against the Federal reserve banks." This has been construed by the Attorney General of the United States as meaning that a Federal reserve bank cannot legally pay any fee to a member or non-member bank for the collection and remittance of a check. It follows, therefore, that if the Federal reserve banks are to give the service required of them under the provisions of section 13 they must, in cases where banks refuse to remit for their checks at par, use some other means of collection no matter how expensive.

The action of the various Federal reserve banks in extending their par lists has met with the cordial approval of the Federal Reserve Board, which holds the view that under the terms of existing law the Federal reserve banks must use every effort to collect all bank checks received from member banks at par. Several of the Federal reserve banks are now able to collect on all points in their respective districts at par, and new additions to the other par lists are being made every day. The Board sees no objection to one bank charging another bank or a firm or individual the full amount provided in section 13 of the Federal Reserve Act (10 cents per \$100) and has not undertaken to modify these charges, but the act expressly provides that no such charge shall be made against the Federal reserve banks.

It is the Board's duty to see that the law is administered fairly and without discrimination and that it applies to all banks and sections alike. It will, therefore, take any and all steps necessary to carry out the intent of the law as construed by the highest legal authority of the Administrative branch of the Government.

The total number of items handled by the twelve Federal reserve banks during the year 1919 (exclusive of duplications) was \$305,158,995, having a total value of a little less than \$136,500,000,000.

During 1920 the policy which has already been outlined was continued. Par maps, published from time to time by the Federal Reserve Board, continued to show an increase in the number of all-par States and increases in the number of the par banks in those States that were not all-par. These maps were widely circulated by the Federal reserve banks and particularly in those districts in which the campaign was being actively carried on; that is to say, the districts in which there were one or more States that were not all-par. Representing in a graphic and easily understood manner the progress of the campaign in the direction of universal par collection, the maps were exceedingly valuable.

The map of April 1st showed the entire United States "white" except the extreme Southeast portion, and in the West, Washington, Oregon, and Arizona. In these three States the non-par banks were reduced to 36, 55, and 12 respectively. The par point map of May 1st showed a slight gain and that of June 1st showed the entire United States in

white except the southeast portion embracing the following States: in the Fifth District, North Carolina and South Carolina; in the Sixth District, Tennessee, part of Mississippi, Alabama, Georgia, Florida, and part of Louisiana; in the Eighth District, the remainder of the State of Mississippi. In these eight States there were 1,481 par banks and 2,103 non-par banks. The situation remained practically unchanged for the remainder of the year 1920. On December 15th non-par banks to the number of 1,732 were reported, divided among the three districts just mentioned.

Up to this time we have considered the progress of the par point campaign from only one standpoint, namely the policy of the Federal reserve banks, the educational campaigns, and the methods finally used to place the remaining non-par banks in each state on the par list. Little or no systematic and concentrated action in opposition appeared until the latter part of 1920. As will be seen from the foregoing account the Federal reserve banks of Richmond and Atlanta did not make as rapid progress as was made in the other Federal reserve districts. It was realized from the beginning that because of banking conditions in these two districts the final fight for exchange would probably take place in the southeastern part of the United States. Therefore, while both banks prosecuted vigorous campaigns of education, in neither case was it thought prudent to hasten matters, but rather to allow the accumulated effect in the other ten districts to assist in the campaigns of education and persuasion. It was not until September 1, 1919, that Maryland was placed on the par list as a whole State; and, as we have already seen, three other States in the Fifth District followed, two in the early part of 1920 and one in the latter part of the same year. In the Sixth District there are no States on the par list as a whole.

During the latter part of 1919 and the early part of 1920 the Federal Reserve Bank of Atlanta advised many, if not all, of the non-member banks in its district that it would shortly accept for collection checks drawn upon them, which checks it would endeavor to collect at par. On June 20, 1920, a number of non-member banks filed petition in the Superior Court of Fulton County, Georgia, for an injunction restraining the Federal Reserve Bank of Atlanta from collecting checks drawn on the plaintiff banks in any other manner than through the mails. The suit was transferred to the United States District Court for the Northern District of Georgia, which decided against the State banks. Appeal was taken to the United States Circuit Court of Appeals for the Fifth Circuit and that court affirmed the decision of the District Court. The case was then appealed by the plaintiffs to the Supreme Court of the United States. In the meantime the various courts have continued the

restraining order pending the final decision and for that reason the Federal Reserve Bank of Atlanta has been unable up to this time to take any action in the direction of placing the states of the Sixth District on the par list as a whole.

On November 19, 1920, the United States Circuit Court of Appeals, Fifth Circuit, rendered an opinion affirming the decision of the District Court of the Northern District of Georgia, held that Federal reserve banks have the right to collect checks drawn on non-member banks which refuse to remit at par by having such checks presented at the counters of the drawee banks and that the case was one in which the United States District Courts had jurisdiction. In the lower courts, however, the defendant had merely demurred to the bill of the plaintiff and no evidence had been taken either to establish or disprove the allegation that the Federal Reserve Bank of Atlanta proposed to use embarrassing and oppressive methods in forcing non-member banks to remit at par. Prior to this time representations had been made to the Federal Reserve Board and to several committees of Congress that improper methods had been and were being used by the Federal reserve banks, particularly in the West and in the Northwest. Many wild tales were afloat as to highhanded procedure of representatives of Federal reserve banks in isolated cases, and it was alleged by the plaintiffs in the Atlanta suit that the Federal Reserve Bank of Atlanta intended to accomplish its purpose by those or similar methods.

When the case finally reached the Supreme Court of the United States on appeal in the October term of 1920, that court affirmed the opinion of the Circuit Court of Appeals with reference to jurisdiction but remanded the case to the United States District Court for the Northern District of Georgia for hearing upon its merits. In rendering the opinion of the court Justice Holmes said: "The question at this stage is not what the plaintiffs may be able to prove or what may be the reasonable interpretation of the defendant's act but whether the plaintiffs have shown ground for relief if they can prove what they allege. We lay on one side as not necessary to our decision the question of the defendant's powers, and assuming that they act within them consider only whether the use that, according to the bill, they intend to make of them will infringe the plaintiffs' rights."

The case was retried on its merits and argued in the District Court of the United States for the Northern District of Georgia, and on March 11, 1922, opinion was rendered by Judge Beverly D. Evans which may be briefly summarized as follows. Under the Federal Reserve Act, Federal reserve banks are empowered to accept any and all checks payable upon presentation when deposited with them for collection. Checks

so received must be collected at par, Federal reserve banks not being permitted to pay exchange in the discharge of their duties with respect to the collection of checks deposited with them; and, with respect to performing the functions of a clearing house, Federal reserve banks are empowered to adopt any reasonable measures designed to accomplish this purpose, and, upon the refusal of the drawee bank to remit at par in satisfactory funds, a Federal reserve bank may employ any proper instrumentality or agency to make the collection and may pay legitimate or necessary costs for such service.

The process of the daily collection of checks in the exercise of clearing house functions is not rendered unlawful because of the fact that of the checks handled two or more of them may be drawn on the same bank. That is to say, Federal reserve banks may accumulate checks from many different sources for prompt presentation to the banks upon which they are drawn. The Federal reserve bank may also publish a par-list, and while it should not include on that list the name of any bank that has not agreed to remit at par or has not authorized the use of its name, it can, through the par list, advise its ability to collect checks upon all banks located in a particular place. The court also found from the facts that the Federal Reserve Bank of Atlanta had not used or proposed to use improper or illegal methods for the purpose of coercing the non-member banks.

Appeal was, of course, taken by the plaintiffs in the suit and after being heard by the United States Circuit Court of Appeals for the Fifth Circuit will probably be again appealed to the Supreme Court of the United States.

During the year 1920 the legislature of several of the states in the Sixth District passed laws the object of which is to prevent Federal reserve banks from making collections upon non-member banks in these states without the payment of exchange.

The act of the Mississippi Legislature, approved March 6, 1920, provides that banks are required to make an exchange or service charge on checks presented through any bank, trust company, Federal reserve bank, post office, express company, or any collection agency, or by any other agency whatsoever, of 1-10 of 1 per cent of the total amount of cash items so presented and paid at any one time. The act specifies a number of exceptions, including checks payable to the State of Mississippi, or any subdivision thereof, or to the United States, and indicates the charge is not to be imposed against citizens of the State making personal presentation of checks payable to them or against banks in the same city, town, or village. It forbids protest of items for non-payment solely on account of refusal or failure to pay exchange.

The act then has a rather unusual provision, as follows: "If for any reason the court should hold that the national banks in this state are not required to charge and collect such exchange, still this act shall remain in full force and effect as to all other banks in this State; and in the event of such holding by the courts, or the refusal of any national bank in this State to comply with this act, then it shall be optional with the State banks located in the same municipality with the national banks or State banks which are members of the Federal Reserve System as to whether such charge shall be made." The act also provides that there shall be no right of action either at law or in equity against any bank in the State for refusal to pay solely on account of non-payment of exchange.

The act of the Louisiana Legislature, having the same object, provides that State and national banks shall have the right to make charges not exceeding 1-10 of 1 per cent, with a minimum in any one case of 10 cents. It also has exceptions similar to those in the act of the Mississippi Legislature and prohibits protest of items for non-payment solely on account of the exchange charge. It also provides that there shall be no right to action either at law or in equity against any bank in the State for refusal to pay solely on account of the ground of non-payment of exchange. The unusual provision above quoted from the Mississippi act, excusing State banks from obeying the law if national banks should refuse to do so, is repeated in this act.

The Legislature of South Dakota passed an act, approved July 3, 1920, allowing banks to make a charge not exceeding 1-10 of 1 per cent, with a minimum of 10 cents on any one transaction. Exceptions: No such charge can be made by a bank for collecting a check presented to said bank when check is drawn on any bank in the same municipality, State, town, or village and does not bear an out-of-town indorsement. Protest for non-payment solely on account of exchange is prohibited and the law provides that there shall be no right of action either in law or in equity against any bank for refusal to pay such items when refusal is based alone on the non-payment of exchange. This act has a special provision peculiar to itself which is as follows: "Whenever one or more checks on any bank in the hands of a single holder or holders for an aggregate sum exceeding amount of such bank's legal reserve required to be kept in its vaults shall be presented on the same date and payment thereof demanded, and said bank may elect to make such payment in exchange instead of cash."

The Legislature of the State of Georgia passed an act, approved August 14, 1920, to amend the Bank Act of the State by an amendment to Section 27, Article 19, by inserting in Section 27, Article 19, after the body of said section and before the proviso, the words, "Provided

that the reserve against savings and time deposits may be invested in bonds of the United States or this State at the market value thereof," and by adding at the end of the said section the following, "And provided that a bank shall have the right to pay checks drawn upon it when presented by any bank, banker, trust company, or any agent thereof, either in money or in exchange, drawn on its approved reserve agents, and to charge for such exchange not exceeding $\frac{1}{8}$ of 1 per cent of the aggregate amount of the checks so presented and paid."

The Legislature of the State of Alabama passed an act, approved September 30, 1920, in which the banks of Alabama are required to charge exchange not exceeding $\frac{1}{8}$ of 1 per cent when paying and remitting for checks drawn upon them and whenever such check or checks are forwarded or presented to a bank for payment by any Federal reserve bank, express company, or post office employee, other bank, banker, trust company, or individual, or by any agent or agents thereof, or through any other agency or individual, the paying bank or remitting bank may pay or remit same at its option either in money or in exchange drawn on its reserve agent or agents in the city of New York or in any reserve city within the Sixth Federal Reserve District. Protest for non-payment solely on the ground of the exchange charge is prohibited.

It is manifest that in enacting the laws above referred to the sole consideration of the various legislatures quoted was to preserve to the State banks of the States the right to charge exchange. The possible effect of these laws upon the banking business of the State or upon the deposit lines of the State banks seems to have had little or no consideration. The fact that many State banks in these States are continuing to remit at par, notwithstanding the careful provisions of law intended to protect them in the charging of exchange, is a very clear indication that many bankers are aware of the fact that competition, the changing customs of trade, and above all the action of inexorable economic law, finally determine these matters and not the acts of legislatures.

As we have already seen, North Carolina was placed on the par list as a whole-par State on November 15, 1920. The suit in the Atlanta District already referred to had been fostered and conducted by an association known as the Bankers Protective Association, organized for the purpose of opposing the activities of the Federal reserve banks for universal par collection. Shortly after November 15, 1920, the Association established a branch in North Carolina, and, through the instrumentality of this branch and the influence of other State bankers, the Legislature of North Carolina, on February 5, 1921, passed an act entitled, "An Act to promote the solvency of State banks," which contained substantially the following provisions:

First. That State banks might lawfully charge exchange at the rate of $\frac{1}{8}$ of 1 per cent, with a minimum fee of 10 cents.

Second. State banks and trust companies chartered by the State are allowed to pay checks drawn upon them by means of their own exchange checks drawn against their reserve deposit in other banks when such checks are presented by any Federal reserve bank, post office, express company, or any respective agent thereof, and unless the checks themselves specify that cash must be paid.

Third. It is made unlawful for any person other than the drawer of the checks to place upon it a notation to the effect that it is payable in cash.

Fourth. Checks drawn in payment of obligations to the State of North Carolina or the United States Government are exempt from exchange charges.

Fifth. The protest of checks is prohibited for non-payment on account of the refusal of the drawee bank to pay exchange.

Believing this law to be unconstitutional, but not knowing just what effect it would produce upon the non-member banks in North Carolina, the Federal Reserve Bank of Richmond immediately notified the non-member banks that it would continue to accept checks drawn upon them and would present them for payment in money in case of the banks' refusal to remit at par. The Federal Reserve Bank of Richmond also notified member banks in its own district and other Federal reserve districts that it would continue to collect North Carolina checks, but, as it did not know the extent to which personal presentation would be necessary, it could not be responsible for occasional delays in presentation beyond the ordinary time. It assured all such banks, however, that it would use the utmost diligence to make prompt presentation in every case in which such action proved to be necessary. Since the Federal Reserve Bank of Richmond did not abandon its policy of collecting all North Carolina checks at par upon the passage of the law, it was necessary for the Bankers Protective Association to take other steps to accomplish its purposes.

An action was brought in the Superior Court of Union County at Monroe, N. C., the object of which was to restrain the Federal Reserve Bank of Richmond from collecting checks upon the non-member banks in North Carolina. At the beginning, 13 non-member banks became plaintiffs in the suit, and, pending hearing of the case, the court granted a restraining order forbidding the Federal Reserve Bank of Richmond to return as dishonored any checks drawn upon the plaintiffs and presented for payment upon which the plaintiffs had tendered their exchange drafts in response to the demand. The Federal Reserve Bank of Rich-

mond promptly discontinued the acceptance of checks drawn upon the 13 plaintiff banks but continued to accept checks upon all other non-member banks and to present them for payment in cash wherever such presentations were necessary. The effect of this action was that other non-member banks became parties to the suit from time to time and the total number finally reached 251 (not including branches) on February 15, 1922.

One curious and interesting feature of the situation is worthy of special note. The restraining order of the court did not forbid the Federal reserve bank's presenting checks and demanding payment in money but forbade only the return of such checks as dishonored. When the Richmond bank received notice of the suit and the names of the plaintiffs, it had in its possession a number of checks that had been duly presented and upon which payment in money had been refused and which had been stamped dishonored by the representatives of the Federal Reserve Bank of Richmond in lieu of formal protest which was no longer obtainable. Under the circumstances these checks could not be returned without contempt of court and the Federal Reserve Bank of Richmond was therefore compelled to hold them and notify indorsers. After notice was received that a bank had joined the injunction suit, no further checks were presented, because the Federal Reserve Bank of Richmond had no wish to embarrass either the plaintiff banks or their customers by holding checks which it could neither collect nor return.

Nevertheless, as additional banks became parties to the suit from time to time, additional checks accumulated in the hands of the Federal Reserve Bank of Richmond, that is, checks presented by agents before the bank had joined the suit but which were still in the hands of the Federal Reserve Bank of Richmond when the notice that the banks had joined the suit was received. At one time more than two thousand of these checks were accumulated, the value of which was many thousands of dollars. In every case indorsers were notified that payment had been refused, but the checks were not returned as dishonored. Eventually arrangements were made by which practically all checks were disposed of either by presentation to the drawee bank, with payment in full in money, or by returning the checks to indorsers with the express permission of the plaintiff banks. As has been already said, no checks were presented to any non-member bank after the Federal reserve bank knew that it had become party to the suit.

The complaint was filed in the Superior Court of Union County and the temporary restraining order awarded on February 29, 1921. The Federal Reserve Bank of Richmond promptly filed petition to remove the case to the United States District Court for the Western District

of North Carolina. This petition was denied and the bank appealed to the United States District Court to take jurisdiction. In the latter part of July, 1921, evidence and argument were heard by the United States District Court on the question of jurisdiction, the main point in the case being whether or not a sum in excess of \$3,000 was involved. The plaintiffs in the suit took the ground that while the right to charge exchange was at the bottom of the whole matter the restraining order of the court dealt only with the right of the Federal Reserve Bank of Richmond to return certain checks as dishonored. Moreover, they filed as evidence in the case approximately 150 affidavits, from as many non-member North Carolina banks, each one to the effect that the right to charge exchange, though a valuable right, was worth less than \$3,000 to the bank by which the affidavit was filed. On July 21, 1921, the judge of the United States District Court entered an order remanding the case to the Superior Court of Union County for trial on its merits.

The Federal Reserve Bank of Richmond filed answer and the case came up for trial at the February, 1922, term in the Superior Court for Union County, North Carolina, held at Monroe, North Carolina. All issues of law and fact were submitted to the judge (that is to say, trial by jury was waived by both sides), evidence was taken, and argument heard from February 27th to March 3d.

Although the complainants had alleged in their bill that the Federal Reserve Bank of Richmond intended to save up checks for the purpose of forcing the non-member North Carolina banks to become parties to the collection system, and that the Federal Reserve Bank of Richmond had used and intended to use various other unusual, unreasonable, and oppressive methods to carry its point, no evidence substantiating this allegation was offered. On the contrary, it appeared from the evidence that the conduct of the Federal Reserve Bank of Richmond throughout the whole of the par point campaign in North Carolina, and throughout all its dealings with the North Carolina member banks before and during the controversy, had been characterized by the utmost consideration for the non-member banks that was consistent with its purpose to carry out what it believed to be the duties imposed upon it by the Federal Reserve Act.

On March 29, 1922, Judge James L. Webb, of the Superior Court for Union County, North Carolina, entered the final order sustaining the act as constitutional and making the temporary injunction permanent. In his statement of the finding of facts, Judge Webb said: "The acts and things done by the defendant as shown herein were done and performed solely with the object and with the intent to discharge what the defendant was advised and believed to be its legal duties and obli-

gations under the act of Congress, and the said defendant was not actuated by any motive or purpose to cause any unnecessary injury or loss to the plaintiff banks, or any of them." In other words, the decision of the Superior Court of Union County, North Carolina, reduced the issue to a conflict between certain provisions of the Federal Reserve Act and the statute passed by the Legislature of the State of North Carolina, reduced the issue to a conflict between certain provisions of the Federal Reserve Act and the statute passed by the Legislature of the State of North Carolina on February 5, 1921, without any complications which in other cases have grown out of alleged courses of conduct actually pursued or intended to be pursued by the Federal reserve bank or its agents. To this judgment the defendant (the Federal Reserve Bank of Richmond) excepted and noted an appeal to the Supreme Court of North Carolina. It is believed that a speedy trial of the case will be had in that court and whatever may be its decision it is probable that appeal will be taken to the Supreme Court of the United States by the losing side.

There are two other cases pending, one between a State bank in Kentucky and the Federal Reserve Bank of Cleveland and the other between a State bank in Oregon and the Federal Reserve Bank of San Francisco, but it is believed that the final decision of the United States Supreme Court in the Atlanta and Richmond cases will settle the conflict.

As we have already stated in commenting upon the acts passed in Mississippi, Louisiana, South Dakota, Georgia, and Alabama, apparently the sole consideration which prompted the various legislatures to pass the acts referred to was the desire to preserve to the State banks the right to charge exchange. It did not seem to occur to the framers of the acts that they might possibly be running counter to an economic law superior to the act of any legislature and the effects of which could in no way be avoided.

After the controversy arose in North Carolina, and especially after a considerable number of banks had become parties to the injunction suit, many complaints were received by the Federal Reserve Bank of Richmond to the effect that checks drawn upon State banks in North Carolina, which had agreed to remit at par in spite of the existence of the law, were being refused by many merchants and other dealers, particularly outside of the Fifth Federal Reserve District. This situation had been foreseen by the officers of the Federal Reserve Bank of Richmond and from time to time after the suit was instituted, in the Superior Court of Union County, lists of the banks that were parties to the suit were sent out by the Federal Reserve Bank of Richmond to all member

banks in the Fifth District and to other Federal reserve banks and branches for the purpose of advising the banks and through them the public generally that the Federal Reserve Bank of Richmond was prepared to collect checks drawn upon all non-member banks in the State of North Carolina except those that had become parties to the suit. In some cases State banks had become parties to the suit but had signified their willingness to continue to remit at par. The names of these banks were, of course, omitted from the list.

The question will naturally suggest itself, "Why did not the Federal Reserve Bank of Richmond publish the names of the banks upon which checks could be collected at par rather than the names of the banks that refused to remit at par?" The answer is that the par list is published at regular intervals by the Federal Reserve Board and that it is impossible to revise that list oftener than once a month. Banks were becoming parties to the suit a few at a time and the Federal Reserve Bank of Richmond had arranged with the counsel for the North Carolina banks to send in advice by telegraph from day to day of additional banks becoming parties to the suit. As soon as the name of a bank was reported as having become a party to the suit, the Federal Reserve Bank of Richmond, of course, ceased to handle checks drawn upon that bank, returning them to the member banks or other Federal reserve banks from which they were received. As a matter of fact, the revised lists of the banks that were parties to the injunction suit were published at intervals much more frequent than once a month. This obviously was necessary to prevent confusion and save time by presenting through other channels checks on the banks that became parties to the suit.

Because it was difficult to keep track of the banks that were parties to the suit, and because especially in localities outside of the Fifth District it was difficult to know whether a given non-member bank in North Carolina was a party to the suit or not, and consequently whether checks drawn upon that bank were collectible at par or subject to exchange charge, many merchants and other dealers took the very natural course of objecting to payment by means of checks drawn upon non-member banks in North Carolina. Though the Federal Reserve Bank of Richmond made every possible effort to protect the interests of those non-member banks that agreed to remit at par, it was unable to do so completely. In other words, all the non-member banks in North Carolina inevitably suffered to some extent from the action of that group of banks which undertook to take advantage of the law and refuse to remit without exchange.

In every case in which a check drawn upon a North Carolina non-

member bank was returned to the drawer as unsatisfactory, the drawer's attention was automatically called to the advantage of maintaining an account with a bank on which checks could be received without question in any part of the United States, and it was but natural to expect some shifting of accounts as a result of the prolonged fight over exchange charges in the state. In order to ascertain what effect, if any, had been had upon the deposits in the North Carolina banks, we recently made a careful comparison of the deposits in three groups of banks at two dates approximately one year apart, December 29, 1920, and December 31, 1921. These three groups did not include all the banks in the State because it was obviously necessary to exclude banks which were in existence on December 29, 1920, but which had gone out of business on December 31, 1921. It was also obviously necessary to exclude all banks that were in existence on December 31, 1921, but had not been organized prior to December 29, 1920. Another group comprising a few small non-member banks was also excluded. This was the group named at the end of the published list of injunction banks and consists of banks each one of which remitted at par for a time after the injunction proceedings were started and then declined to remit at par, and declined also to pay in cash but tendered exchange drafts when checks were presented at their counters by representatives of the Federal reserve bank.

After December 29, 1920, there was a very general decrease in the deposits of practically all banks, many of which, however, recovered their deposits in whole or in part before the end of 1921. In other words, under existing conditions banks were really making some progress in building up deposits when they could show deposit lines at the end of 1921 equal to those at the beginning of that year.

The 102 member banks in North Carolina held deposits on December 29, 1920, amounting to \$130,551,000. The deposits of these same banks on December 31, 1921, were \$131,395,000, an increase of \$844,000 or 0.65 per cent.

The 209 non-member banks remitting at par had deposits on December 29, 1920, of \$94,532,000. On December 31, 1921, the deposits of these same banks amounted to \$86,027,000, a decrease of \$8,505,000 or 9 per cent.

The 247 injunction banks had deposits on December 29, 1920, of \$54,380,000; the deposits of these same banks on December 31, 1921, amounted to \$49,240,000, a decrease of \$5,140,000 or 9.5 per cent.

If changes in the total deposits indicated in the above State are attributable to the fact that certain non-member banks in the State were not remitting at par, it would seem that all non-member banks were

more or less affected but that the non-remitting non-member banks were affected to a slightly greater extent than those that continued to remit at par.

There are several elements in this controversy which do not seem to be very generally recognized and appreciated.

First. A profit from exchange charges (particularly since the transportation of money for the purpose of creating exchange is no longer necessary) is possible only if the bank charging the exchange on checks presented to it for payment is not also required to pay exchange on checks drawn upon other banks and deposited with it by its customers.

Second. Since the establishment of the Federal Reserve System and the development of the par collection plan, country banks are no longer in a position to collect exchange on the one hand and to be relieved from paying it on the other. The Federal reserve banks have brought the whole matter to an issue and the real question is not whether certain banks shall be allowed to continue to charge exchange, while others are required to meet checks drawn upon them at par, but whether all banks shall be given the right to charge exchange or no banks be allowed to charge exchange.

Third. Like other features of the Federal Reserve System, the par collection principle is not an arbitrary plan devised by Congress and imposed upon the banks of the country. Prior to the establishment of the Federal Reserve System many if not all banks in certain sections had begun to remit at par. In all parts of the United States country clearing houses were being established for the purpose of reducing or eliminating exchange charges. The establishment and development of the par collection system by the Federal reserve banks is, therefore, the result of a gradual growth and a gradual change in banking methods. Undoubtedly this growth was greatly stimulated, and the results have been very much hastened during the recent years, by the establishment of one universal system in place of the many independent systems that existed previously, but without the previous development of the par collection idea the plan could never have been developed as rapidly as it has been since July 15, 1916.

Fourth. It is a mistake to assume that the par collection system of the Federal reserve banks can remain incomplete, as it is at present. It must either go forward or backward. Even though we might be able to compel member banks to forgo exchange charges we could not compel non-member banks to do so. As we have seen from the figures reported from time to time, thousands of these non-member banks have joined the par list on the strength of our assurance that ultimately all banks would be included in the collection system. While we may expect a

great deal of patience on their part and a liberal allowance of time for the perfection of the system, we cannot expect them to continue to co-operate if we should abandon our efforts to collect at par from other non-member banks, in many cases their close neighbors and possible competitors.

Fifth. Through its leased wire system, already referred to, and through the establishment of the Gold Settlement Fund, the Federal reserve banks have been able to develop and offer to the public, through member banks, enormous facilities hitherto unknown in this country. Should the fight for universal par collection be abandoned, and particularly should many of the non-member banks and eventually many of the member banks, relapse into the former practice of charging exchange, and should the re-establishment of this practice interfere with the collection of checks through the Federal reserve banks, it is not only possible but extremely probable that many of those other important services would have to be curtailed or entirely abandoned.

Rapid developments are sometimes looked upon with suspicion and we are tempted to ask ourselves whether it is not likely that a period of reaction will set in. This is, of course, the case with reference to anything the development of which is brought about by purely arbitrary conditions. There are other cases in which the tendency to develop is forcibly held back for a long period because of the absence of some conditions necessary to normal growth. In these cases, when the favorable conditions come into existence, development is not only rapid but in some cases it is spectacular and all the growth gained is held without reaction but on the contrary more is gained as time goes on.

This we believe to be the case of the present system of par collections. As we have seen, for many years there had been a slow but sure tendency in the direction of the free exchange of checks the benefits of which to trade and commerce should be manifest to anyone. There were, however, two great obstacles in the way of development.

First. There was no organization in existence which could afford to make the necessary outlay in time and patience and money, although the object to be gained was well worth the expenditure of all these to the commercial and banking progress of the country.

Second. Under banking conditions as they existed prior to the establishment of the Federal Reserve System, it was impossible to co-ordinate in an economical manner and under one system even the collection channels which had been already developed, much less to develop new channels which would enable such a system to reach all parts of the country and to make what is practically one general settlement each day of all

clearing transactions in all parts of the United States; and until this one universal system was possible the greatest economy in transfer of money for the settlement of balances could not be attained.

FEDERAL RESERVE BANK OF RICHMOND.

Postscript.

As we have already stated, Judge James L. Webb, of the Superior Court of Union County, North Carolina, entered a decree on March 29, 1922, making permanent the temporary injunction granted in the suit that certain non-member banks in North Carolina had brought. An appeal was taken by the Federal Reserve Bank of Richmond to the Supreme Court of North Carolina. The case was argued on May 17th and just as this letter was going to press the lower court was reversed by a unanimous decision, the opinion being written by Chief Justice Walter Clark.

After reciting the facts in the case substantially as we have already stated them, and after disposing of several matters of minor importance the opinion reads as follows:

The Statute of N. C., Chapter 20, 1921, was intended for the benefit of the State banks in this State, by authorizing them to continue to charge exchange for remitting collection of checks presented to them for payment, by sending their own checks for less than the face amount of the check sent here for collection, but however desirable that policy may be, it is clearly in conflict with the valid constitutional provision of the Federal statute. No Act of this State can authorize the drawee bank to pay less than the face amount of the check drawn upon it by its depositor or to remit its check in payment or pay it otherwise than in legal tender money. Nor can it require that the Federal reserve bank shall pay a fee or that the bank here may remit less than the face value of the check when the Federal statute forbids such charge. It is true that the Federal reserve bank as holder of the check has no contract rights with the drawee bank until the check is presented, but as holder it can require payment of the face amount on the check in legal tender and under the Act of Congress it cannot pay a deduction from that face value by accepting a remittance to the reserve bank of a lesser amount. The reserve bank always incloses with the check sent to the payee bank a stamped and addressed envelope for the check to be remitted in payment, which must be for the face amount of the check sent.

The Federal statute, being a regulation of the Federal Corporation by Congress, the Act of this State authorizing the payee bank here to exact exchange is in direct conflict with the duty imposed upon the Federal reserve bank by the Act of Congress and the reserve bank acts within its duty to observe the provision of the Federal Act by refusing to receive a check for less than the face amount of the check sent by it for collection. It is true it cannot enforce payment of the face amount except by personal presentation of the check at the counter of the payee bank but it has a right to refuse a check sent to it by the payee bank for less than the full face amount and to protest the check it has sent here for collection for non-payment. The matter then becomes one between the drawer of the check and the payee bank who refuses to pay it.

The U. S. Constitution, Art. VI. (Sec. 2) provides that the Constitution of the U. S. and the laws in pursuance thereof, "shall be the supreme law of the land; and the judges in every State shall be bound thereby, anything in the Constitution or laws of any State to the contrary notwithstanding." In the matter before us the Act of Congress which provides that no exchange shall be allowed by the reserve bank for remitting for the collection of any check by any bank is in direct conflict with the statute of this State authorizing the payee bank to remit a lesser amount than the face amount of any check paid by it if presented by the Federal reserve bank. In this conflict of authority, the Federal law is supreme. The injunction, therefore, was improvidently granted and the judgment must be *REVERSED*."

The attorneys for the plaintiffs in the original suit have signified their intention of taking an appeal to the Supreme Court of the United States by writ of certiorari. As that Court is on the point of adjournment and will adjourn before the paper could possibly be prepared, the Supreme Court of North Carolina has been requested, with the consent of all parties concerned, to withhold its judgment until the beginning of the fall term of the Supreme Court of the United States. The Federal Reserve Bank of Richmond had no hesitancy in agreeing to the suspension because its principle from the beginning has been to do those things which the law requires of it but with the utmost possible consideration for the member and non-member banks involved in any case.

The Federal Reserve System.

From the Report of the Comptroller of the Currency for 1921, p. 120.

The development of the Federal reserve system since its inauguration in 1914 as shown by statements issued by the Federal Reserve Board during the latter part of November of each year since 1914, with the exception of the statement for the year 1921, which is for October 26, is shown in the following table:

[In thousands of dollars.]

	Nov. 27, 1914.	Nov. 26, 1915.	Nov. 24, 1916.	Nov. 16, 1917.	Nov. 22, 1918.	Nov. 28, 1919.	Nov. 26, 1920.	Oct. 26, 1921.
ASSETS.								
Gold.....	227,840	321,068	459,935	1,584,328	2,060,265	2,093,641	2,023,916	2,786,239
Other assets.....	34,630	37,212	17,974	52,525	55,992	66,025	171,364	150,909
Bills.....								
bought.....	7,383	48,973	122,593	681,719	2,078,219	2,709,804	2,983,133	1,371,075
United States securities.....		12,919	50,594	241,906	177,314	314,937	320,614	190,946
Municipal warrants.....		27,308	22,166	1,273	27			
Federal reserve notes— net.....		19,176	15,414					
Due from Federal re- serve banks—net.....		14,053	43,263					
Uncollected items.....				428,544	819,010	1,013,426	709,401	540,067
All other assets.....	165	4,633	3,121	22,111	28,700	32,208	36,152	55,679
Total.....	270,018	485,342	735,060	3,012,406	5,219,527	6,230,041	6,244,580	5,094,915
LIABILITIES.								
Currency in circulation.....					80,025	87,001	99,020	103,007
Other liabilities.....					1,134	81,087	164,745	213,824
net.....					113,174	98,157	15,909	46,624
Due to member and nonmember banks.....	249,268	397,952	637,072				1,734,691	1,669,059
All other deposits.....				1,501,423	1,718,000	1,943,232		
Federal reserve notes— net.....								22,873
Federal reserve bank notes in circulation.....	2,700	13,385	14,296	1,972,585	12,555,215	12,852,277	3,325,629	2,408,779
Other liabilities.....			1,028	8,000	80,504	256,793	214,610	88,024
net.....				240,437	620,608	881,436	582,442	466,044
All other liabilities.....		4,113		4,383	50,867	50,058	107,534	76,681
Total.....	270,018	485,342	735,060	3,012,406	5,219,527	6,230,041	6,244,580	5,094,915

In actual circulation.

FEDERAL RESERVE STATEMENT.

The following table shows the total gold holdings and other chief items in this week's report of each of the twelve Federal Reserve Banks:

District.	Gold Reserve.	Rediscounts on Government War Paper.	Total Bills on Hand.	Due Members' Reserve Acct.	Ratio of Reserve to Deposits	
					F.R. Notes and in Circulation.	Notes.
Boston	\$206,584,000	\$22,079,000	\$35,116,000	\$123,722,000	\$183,568,000	68.5
New York	1,060,536,000	134,900,000	221,302,000	713,569,000	580,198,000	82.9
Philadelphia	225,602,000	35,374,000	64,217,000	109,049,000	200,029,000	76.7
Cleveland	284,502,000	22,875,000	92,965,000	140,208,000	227,572,000	73.5
Richmond	103,773,000	19,905,000	47,205,000	58,690,000	96,868,000	73.1
Atlanta	127,363,000	5,082,000	50,306,000	53,681,000	124,046,000	74.8
Chicago	521,413,000	32,708,000	97,069,000	253,572,000	396,260,000	82.6
St. Louis	102,622,000	12,077,000	39,298,000	63,722,000	93,899,000	69.8
Minneapolis	80,296,000	2,187,000	21,340,000	48,124,000	57,090,000	75.9
Kansas City	89,360,000	6,625,000	28,584,000	77,495,000	68,734,000	62.4
Dallas	53,179,000	1,079,000	55,568,000	54,752,000	40,687,000	61.3
San Francisco	251,093,000	13,174,000	79,408,000	192,176,000	220,439,000	70.3

In the Previous Week,

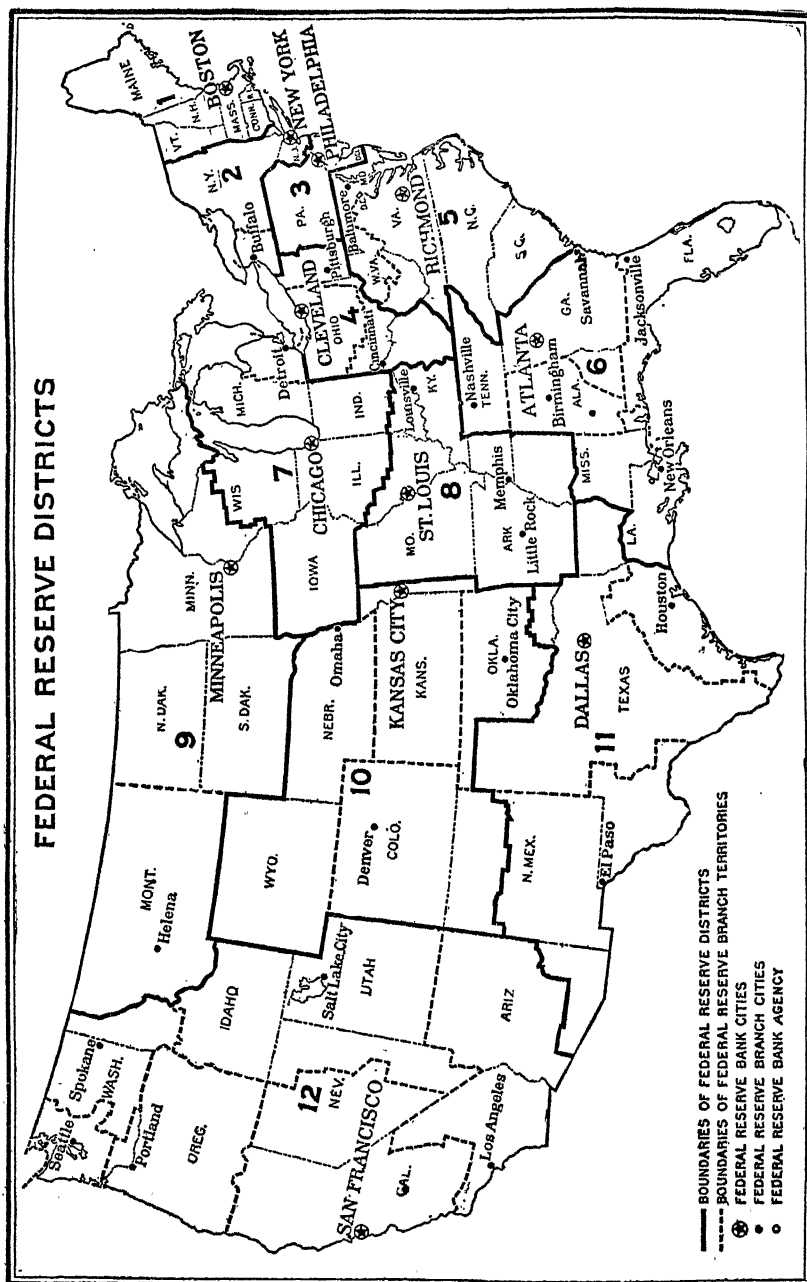
District.	Gold Reserve.	Rediscounts on Government War Paper.	Total Bills on Hand.	Due Members' Reserve Acct.	Ratio of Reserve to Deposits	
					F.R. Notes and in Circulation.	Notes.
Boston	\$203,886,000	\$21,855,000	\$100,664,000	\$131,528,000	\$195,257,000	65.6
New York	1,025,036,000	153,961,000	269,656,000	711,072,000	588,415,000	78.7
Philadelphia	225,587,000	35,467,000	70,178,000	113,354,800	204,862,000	74.8
Cleveland	261,204,000	29,106,000	93,878,000	149,786,000	229,100,000	70.6
Richmond	110,688,000	18,523,000	44,043,000	59,255,000	97,101,000	75.3
Atlanta	130,602,000	3,576,000	45,066,000	52,693,000	125,192,000	76.3
Chicago	527,506,000	26,829,000	87,828,000	236,149,000	386,174,000	83.5
St. Louis	104,212,000	13,721,000	41,732,000	65,187,000	95,762,000	69.2
Minneapolis	80,627,000	2,031,000	21,456,000	47,506,000	56,075,000	76.6
Kansas City	91,652,000	7,406,000	30,467,000	79,879,000	68,982,000	62.6
Dallas	53,025,000	1,211,000	36,665,000	56,049,000	41,888,000	60.1
San Francisco	250,853,000	10,599,000	71,380,000	137,188,000	221,984,000	72.0

Consolidated statement of twelve Federal Reserve Banks compares as follows:

	Nov. 22, 1922.	Nov. 15, 1922.	Nov. 23, 1921.
Gold and gold certificates.....	\$289,750,000	\$276,414,000	\$485,108,000
Gold settlement fund, Fed. Reserve Board..	651,862,000	651,930,000	425,833,000
Total gold held by banks.....	\$941,612,000	\$928,344,000	\$910,941,000
Gold with Federal Reserve agents.....	2,077,582,000	2,078,801,000	1,811,816,000
Gold redemption fund.....	69,131,000	66,603,000	112,972,000
Total gold reserves.....	\$3,088,325,000	\$3,073,848,000	\$2,835,229,000
Legal tender notes, silver, &c.....	130,358,000	130,912,000	142,999,000
Total reserves.....	\$3,218,683,000	\$3,204,760,000	\$2,978,228,000
Bills discounted:			
Secured by U. S. Government obligations..	307,976,000	330,285,000	467,168,000
All other.....	306,215,000	322,820,000	738,007,000
Bills bought in open market.....	237,405,000	260,894,000	69,375,000
Total bills on hand.....	\$871,596,000	\$913,699,000	\$1,274,545,000
United States bonds and notes.....	151,731,000	171,732,000	32,486,000
U. S. Certificates of Indebtedness—one-year certificates. (Pittman act).....	28,500,000	31,500,000	181,000,000
All other.....	114,888,000	122,482,000	97,834,000
Municipal warrants.....	27,000	27,000	22,000
Total earning assets.....	\$1,166,742,000	\$1,230,440,000	\$1,478,867,000
Bank premises.....	46,204,000	45,650,000	\$2,949,000
Five per cent. redemption fund against Federal Reserve Bank notes.....	3,410,000	3,535,000	7,903,000
Uncollected items.....	634,519,000	821,132,000	544,393,000
All other resources.....	14,905,000	15,070,000	18,732,000
Total resources.....	\$5,134,163,000	\$5,329,587,000	\$5,056,092,000

LIABILITIES.

Capital paid in.....	\$196,495,000	\$106,448,000	\$108,216,000
Surplus.....	215,398,000	215,398,000	215,324,000
Deposits:			
Government.....	45,198,000	87,252,000	32,155,000
Member banks—Reserve account.....	1,529,069,000	1,859,652,000	1,670,717,000
All other.....	20,721,000	22,606,000	25,622,000
Total deposits.....	\$1,894,988,000	\$1,939,510,000	\$1,728,497,000
Federal Reserve notes in actual circulation..	2,290,391,000	2,321,219,000	2,389,816,000
Federal Reserve Bank notes in circulation—Net liabilities.....	26,220,000	29,327,000	74,765,000
Deferred availability items.....	634,796,000	691,406,000	468,110,000
All other liabilities.....	26,875,000	26,279,000	79,764,000
Total liabilities.....	\$5,134,163,000	\$5,329,587,000	\$5,056,092,000
Ratio of total reserves to deposit and Federal Reserve note liabilities combined.....	76.7%	75.2%	72.3%



Suggested Readings on Chapter XVII.

Willis, H. P.—The Federal Reserve.

Reed, H. L.—The Development of Federal Reserve Policy.

Annals of American Academy—The Federal Reserve System:
Its Purpose and Work. Volume 99, No. 188 (Jan.,
1922).

Hollander, J. H.—War Borrowing.

Kemmerer, E. W.—A. B. C. of the Federal Reserve System.

Wright, I.—Bank Credit and Agriculture, Part III.

Moulton, H. G.—Financial Organization, Chapters XXV and
XXVI.

Phillips, C. A.—Readings in Money and Banking, Chapter
XXXI.

Annual Reports of the Federal Reserve Board.

The Federal Reserve Bulletin (monthly).

Monthly Reviews of the Federal reserve banks, especially of
New York, of Boston, of Philadelphia, of Cleveland, and
of Chicago.

Questions and Problems on Chapter XVII.

1. Find the total number of State banks and the number which are members of the Federal Reserve System. What percentage of the total banking power do the members represent?

2. How many members of the Federal Reserve Board does a President appoint in one term?

3. What are the likenesses and differences between the Federal Reserve Board and the State Bank of Indiana?

4. What percentage of the banking capital of a district would a syndicate need to control, in order to dictate the selection of a majority of the directors of a Federal reserve bank?

5. A bank has \$10,000,000 capital and \$4,000,000 surplus; how much capital stock of the Federal reserve bank must it subscribe for? Pay in? How much is it liable for?

6. If the New York Federal Reserve Bank had earnings of \$10,000,000, how would they be divided?

7. Comparing the different districts with respect to the number of branches they have, what seems to be the determining factors?

8. If you wished to start a bank and wished to be a member of the Federal reserve system, would you take a State or national charter?

9. Can the Federal Reserve Board control in any way the loaning policy of a member bank or prevent it from making call loans on the Stock Exchange?

10. Why should the control of the Federal Reserve Board be so absolute over the Federal reserve banks? Why should not the owners have more control?

11. From the current *Federal Reserve Bulletin*, find the percentage held:

a. Of agricultural paper.

b. Of bankers' acceptances.

c. Of trade acceptances.

12. Why should agricultural paper be allowed a longer maturity than commercial paper?

13. Could a Federal reserve bank buy the note of a packing company in the open market? A trade acceptance?

14. How much can the National City Bank loan on real estate?

15. With \$1,000,000 of gold, how many Federal reserve notes could a bank issue?

16. How much credit expansion could \$1,000,000 of gold in a Federal reserve bank support in central reserve city banks? In reserve city banks? In country banks?

17. Contrast the method by which a check on a Providence, Rhode Island, bank would formerly have been collected by a Cincinnati, Ohio, bank, with the method now in use.

18. Lumber dealers in a certain district of the South sell their lumber and take trade acceptances in settlement. Suppose that the local banks had reached their limit in granting loans. Could the lumber dealers get money on the trade acceptances from the Federal reserve bank of the district?

19. A bank in New York City has a capital of \$200,000, and a surplus and undivided profits of \$153,125. Its paid-up stock in the Federal reserve bank is \$9,000. What is the amount of the surplus?

20. How much stock in the Federal reserve bank would the National City Bank have to subscribe to? Pay in?

21. If the earnings of \$1,000,000 go \$100,000 to surplus and \$900,000 to the Government, you can estimate the minimum amount of surplus of the bank as what?

22. In a certain State, the minimum requirement for capital of a State bank is \$10,000; a bank in that State has \$15,000 capital and \$10,000 surplus. Is it eligible to join the Federal reserve system?

23. Is J. P. Morgan & Co. eligible to join the Federal reserve system?

24. What provision of the Federal Reserve Act authorizes the Federal Reserve Board to conduct the gold settlement fund? The Federal reserve banks to conduct par-check collection?

25. The Emigrant Industrial Savings Bank is a mutual savings banks. Is it eligible to join the Federal reserve system?

CHAPTER XVIII.

CO-OPERATIVE AND AGRICULTURAL CREDIT.

Building and Loan Associations.

This is the most successful form of co-operative credit in the United States. Small payments made at regular intervals are loaned to members to provide homes.

Stock is sold with a par value, say, of \$500. The member pays 50 cents a week until the amount paid in, plus the earnings, equals \$500. If the member has been an investing one, he gets that amount of cash. The borrowing members must take out stock, the par value of which will equal their loan. When it matures, the loan is canceled.

Co-operative Labor Banks.

These banks are regularly organized under the State or national banking laws. Sometimes only members of the union can hold stock. The co-operative feature consists in limiting the dividend to stockholders and sharing the profits with the depositors.

Co-operative Credit Unions.

Abroad, the Raiffeisen and Schulze-Delitzsch systems have had great growth. The growth of co-operative credit unions in the United States has not been so rapid, though some States have laws to facilitate their organization. The unions are usually based on the principle of giving each member one vote, irrespective of the amount of stock held. Often the union borrows funds to loan to its members and on borrowings the members are liable to an unlimited extent. The basis of the credit is largely personal. The intimate knowledge the members have of each other makes it possible to lend on this basis. In the United States the credit unions are of two types: (1) those in agricultural regions; (2) those among wage earners formed for the purpose of obtaining consumption loans.

Federal Farm Loan System.

1. Purpose.

It aims to provide long-time credit to farmers at low rates.

2. Method.

Under public supervision, tax-free bonds are issued against farm mortgages.

3. Organization.

a. Federal Farm Loan Board. This board is composed of the Secretary of the Treasury and four members appointed by the President, and has control of the system.

b. 12 Federal land banks. The districts are not the same as the Federal reserve bank districts, since there are naturally more of them in the West. The banks have a capital of at least \$750,000, partly furnished by the Government. Temporarily the banks are being run by five directors appointed by the Federal Farm Loan Board.

c. National farm loan associations. These are made up of borrowers. There are over 4,000 of them. Each borrower subscribes 5 per cent of his loan in stock. This stock carries double liability.

4. Loans.

Loans are made on first mortgages. The amount is limited to 50 per cent of the value of the land and 20 per cent of the value of the permanent insured improvements. The duration of the loans is from five to forty years with the option of repaying any part of the principal after five years. The loans are made on the amortization principle.

5. Joint stock land banks.

These are privately owned but supervised by the Federal Farm Loan Board. The bonds they issue are tax exempt. They are less restricted in making loans than the Federal land banks.

Materials on Chapter XVIII.**Selected Sections from the Banking Law of New York.***§375. Incorporation; Organization Certificate.*

When authorized by the superintendent of banks as provided in section twenty-three of this chapter, fifteen or more persons, residents of the State of New York, may form a corporation to be known as a savings and loan association. Such persons shall subscribe and acknowledge and submit to the superintendent of banks at his office an organization certificate in duplicate, which shall specifically state:

1. The name by which the association is to be known, which shall contain as a part thereof the words "savings and loan association."

2. The place where its business is to be transacted.

3. The name, occupation, place of residence and post-office address, including street and number, if in a city, of each incorporator and the number of shares for which he has subscribed.

4. The matured value of the total number of shares for which the incorporators have subscribed, which shall be at least twenty-five thousand dollars.

5. The number of the directors of the association, which shall not be less than seven or more than fifteen, and the names of the incorporators who shall be its directors until the first annual meeting. The incorporators named as directors must possess the qualification of directors specified in section four hundred five of this article.

§378. General Powers.

In addition to the powers conferred by the general corporation law, every savings and loan association shall, subject to the restrictions and limitations contained in this article and its by-laws, have the following powers:

1. To issue the shares described in section three hundred eighty-three of this article to persons qualified for membership, and deliver to them certificates or pass-books representing such shares; to receive from its members the sums of money, or dues, payable on such shares; to invest the moneys so received in the property and securities prescribed in section three hundred eighty-four of this article; to borrow money as provided in section three hundred eighty-eight of this article; to declare and credit dividends in the manner prescribed in this article; and to exercise by its board of directors or duly authorized officers, agents or representatives, subject to law, all such incidental powers as shall

be necessary to carry on the business of a savings and loan association, in accordance with the intent and purpose of this article.

2. To charge an entrance or membership fee upon shares issued by it, and to permit the transfer of shares upon the payment of a transfer fee and upon compliance with its by-laws.

3. To charge premium or interest in excess of the legal rate, upon loans to members; to fine members who fail to pay punctually the sums of money, or dues, required upon their shares, or the interest or premium upon the loans obtained by them; to impress a lien upon the shares of any member to the extent of any lawful fines or other obligations due to it.

4. To mature shares and pay to the holders thereof the matured value of such shares; to permit members to withdraw their shares and pay to such members the withdrawal value thereof; to retire shares and pay to the holders of the shares so retired the full value thereof; and to suspend and forfeit shares held by delinquent members.

5. To assign to the land bank of the State of New York bonds and mortgages and other securities owned by the association as security for the payment of debenture bonds issued for its account; to guarantee the payment of such debenture bonds; to exercise such other powers as may be conferred upon member associations of such land bank; and to perform such duties and obligations as may be lawfully required of such member associations.

6. To do all other acts authorized by this article.

Any savings and loan association, duly organized under any law of this State and engaged in business prior to April sixteen, nineteen hundred and fourteen, may invest in shares of the land bank of the State of New York and exercise all the powers conferred by subdivision five of this section, by the affirmative vote of a majority of its board of directors, taken by ayes and nays, and duly recorded in the minutes of said board and may, by like authority, elect a representative to vote at meetings of the land bank, nominate a director or directors of such land bank, and exercise all the powers conferred by law upon member associations of such land bank, without amending its by-laws and notwithstanding any restriction upon its investments contained in such by-laws on April sixteen, nineteen hundred and fourteen.

Constitution and By-Laws of the Hillsdale Loan and Building
Company of Cincinnati, Ohio.

CONSTITUTION.

ARTICLE I.

Purpose and General Powers.

SECTION 1. This Association is the same that has been long and favorably known as the Hillsdale Loan and Building Company, of Cincinnati, Ohio. This new Constitution has been adopted to meet the enlarged powers given by the Statute of 1908, but it is not intended to make any break in the continuity of the Company, nor to interfere with the terms of the present officers or employees, or the regulations applying to them.

SEC. 2. The Association is organized on the perpetual plan for the purpose of raising money to be loaned to its members and others, and for such other purposes as are authorized by law.

SEC. 3. This Association shall have all the powers which the Building Association Statutes of Ohio either now or may hereafter permit, except as the same may be specifically restricted by terms of this Constitution.

ARTICLE II.

Name and Location.

SECTION 1. The name of this Company shall be: "The Hillsdale Loan and Building Company."

SEC. 2. Its place of business shall be Cincinnati, Hamilton County, Ohio.

ARTICLE III.

Capital Stock and Shares.

SECTION 1. The Capital Stock shall be One Million Dollars, divided into shares of Five Hundred Dollars each.

SEC. 2. Stock may be issued to members in whole or fractional shares, upon such terms as the By-Laws may provide, and paid out or withdrawn shares may be reissued.

ARTICLE IV.

Officers.

SECTION 1. The affairs of the Association shall be governed by a Board of Directors, consisting of twelve members to be elected. But

the Board may decrease annually the number to not less than nine members.

SEC. 2. A President, Vice-President, Secretary, and Treasurer, shall be chosen annually by the Board from its own number, and the Board may create such committees as deemed necessary.

SEC. 3. All officers and members of standing committees shall serve until their successors are elected and qualified.

SEC. 4. All vacancies in the Board, if less than a majority, or in any of the offices, may be filled by the Directors for the unexpired term.

ARTICLE V.

Membership, Dues, Etc.

SECTION 1. Any person or persons, jointly, or any firm or corporation, may become a member of this Association at any time without paying back dues, by subscribing for or becoming owner of any one or more shares, and shall share in the profits in proportion to the credit of the member.

SEC. 2. Every member shall pay weekly fifty cents per share dues until the dues and profits credited amount to \$500 per share, when the obligation will be canceled and he will receive his money in turn, and shall then lose all claim on the Association.

SEC. 3. The Board may impose an initiation fee on borrowers or non-borrowers, or both, and may require a weekly premium from borrowers.

SEC. 4. Each member shall pay 25 cents for a pass-book.

ARTICLE VI.

Meetings and Elections.

SECTION 1. The annual election of Directors shall be held at the office of the Association on the third Wednesday in September of each year, between the hours of 7.30 and 9. P.M.

SEC. 2. The annual meeting of the members shall be held in September, at such time and place as the board may select.

SEC. 3. Special meetings shall be called by the President upon the order of the Board of Directors, or upon the written request of not less than ten members.

SEC. 4. A majority of the members at such meetings shall constitute a quorum.

SEC. 5. At all meetings of the members each member, including minors, having stock of record for at least thirty days prior thereto, shall be entitled, either in person or by proxy, to one vote for each share so held of record by the member, and a proportionate fractional vote

for each fractional share, but shall not vote more than twenty shares in his own right, nor cumulate his votes.

SEC. 6. Two weeks previous to the annual election the Board of Directors shall appoint from the shareholders three delegates, who shall nominate twice as many candidates for Directors, as there will be vacancies to be filled, and submit their names to the board at the next regular meeting. Members, however, shall have the privilege to nominate an independent ticket. The ticket thus nominated must be posted conspicuously in the place of meeting one week, after two weeks' notice in one English and one German newspaper of general circulation in the county, previous to the election.

SEC. 7. Voting for Directors shall be by ballot, and the three delegates appointed as aforesaid shall act as judges at the election.

SEC. 8. The Directors shall be installed at the next regular meeting, and shall thereupon organize after the election.

SEC. 9. The regular weekly meetings for the payment of all moneys and transactions of business, shall be held every Wednesday at such place, as may from time to time be designated.

ARTICLE VII.

General Powers and Duties of Directors.

SECTION 1. The Board of Directors shall hold weekly meetings at the time and place of the meetings for payment of dues, etc.

SEC. 2. A majority shall constitute a quorum.

SEC. 3. The Board shall appoint an Attorney or legal firm to hold at the pleasure of the board, and subject to removal for cause, and may employ clerical or other assistance, as deemed necessary.

SEC. 4. The board shall require officers having charge of money, securities or property, to be under bonds, signed by at least two sureties or a surety company, and shall judge of the sufficiency thereof. They shall fix the salaries and compensation of officers and employees, and may remove or suspend any officer or employee for malfeasance or neglect.

SEC. 5. They shall designate a bank or banks, in which the Treasurer shall deposit all funds in the name of the Association. Funds can only be withdrawn from the depository by check signed by the President (or Vice-President in his absence), Secretary and Treasurer, or any two of them, and only after the expenditure has been authorized by the board.

SEC. 6. They shall have power to borrow, whenever necessary, any sums up to 20 per cent of the assets, required to meet current demands for loans or withdrawals, at not exceeding the legal rate of interest.

SEC. 7. They shall have power to create an undivided profit fund, receive deposits and joint survivorship accounts.

SEC. 8. They shall have power to adopt, amend, enforce and repeal By-Laws for the government of the Association, the making of loans and whatever else is necessary in the exercise of the powers authorized by law.

ARTICLE VIII.

Deposits.

SECTION 1. The Board may at any time receive deposits of money from any order, society, firm, person or persons, and issue for the same a certificate or note signed by the President and Secretary, or a pass-book, and the deposit may bear such interest, not exceeding the legal rate, as the board decides.

SEC. 2. Such deposits may be withdrawn on the same terms as dues, but the board may order repayment at any time, in which case interest shall be paid up to the date of order, but not after.

ARTICLE IX.

Loans.

SECTION 1. Security shall be by mortgage on real estate in Hamilton County, Ohio, held in fee simple or by perpetual leasehold, or lease with privilege of purchase, and with insurance, if required, or in such other security as is allowed by law. No loan shall exceed two-thirds of the valuation reported by the Appraising Committee, the board to be sole judge of the sufficiency of the security. Such mortgage shall be in force until dues and dividends credited, less all the amounts due the Association, amount to \$500 per share, when the mortgage shall be returned with satisfaction indorsed.

SEC. 2. A member to whom money is awarded shall submit a description of his security at the next meeting of the board, subject to a fine of 50 cents per share for further delay, and subject to revocation of the award. He shall deposit with the Secretary at least \$20 to cover expenses of appraisement, examination of title and other charges. But a member desiring to purchase real estate to give as security may have the same appraised by depositing sufficient initial payment for the fees of the Appraising Committee and pay the balance on the coming in of their report.

SEC. 3. Dues, interest and premium, if any, shall be paid weekly at the meetings. Weekly interest shall be 58 cents per share, subject to alteration by the board between the limits of 50 and 60 cents per share.

The board may allow an annual rebate of interest, in which event dividends will be allowed only on dues paid in during the preceding fiscal year.

SEC. 4. All taxes and assessments, fire insurance policies, ground rents, etc., must be promptly paid by the mortgagor, and it shall be the duty of such mortgagor to present to the board the proper receipts therefor at the meeting next following the date when such payments become due, or be liable to such fines and proceedings as the Board of Directors may deem necessary, and, if paid by the Association, shall be covered by his mortgage and bear interest at the rate of the principal debt.

SEC. 5. Any member may have his loan canceled and security returned on such terms as the board requires. But if premiums are charged and cancellation is required during the first year of the loan, a full year's premium shall be charged.

SEC. 6. Loans on pass-books may be made for not over one year to members on shares not advanced on mortgage security, to an amount not exceeding nine-tenths of the member's credits therein, on giving a note to the Association and transferring the pass-book as collateral security. But such members shall continue to pay dues. The interest paid on said loans shall be as follows:

\$25.00 to	\$50.00.....	10 cents.
51.00 to	75.00.....	15 "
76.00 to	100.00.....	20 "

SEC. 7. Loans evidenced by a note and secured by mortgage may also be made for a period not exceeding five years, at any time at a rate of interest amounting to not less than 50 cents nor more than 60 cents per week, for each \$500 loaned. Interest to be paid weekly, or at longer periods not exceeding six months as the board and borrower may agree, and the principal to be repaid in bulk or in installments at any time in sums of \$50, or some multiple thereof, with reduction of interest at the rate of five cents per week for every \$50 repaid, but without dividends.

SEC. 8. If any dues, interest, taxes, assessments, ground rents, or insurance premiums are in arrears, the entire sum secured by the mortgage shall become due and the Board of Directors may foreclose or take a personal judgment, if necessary.

ARTICLE X.

Earnings.

SECTION 1. After paying all expenses and placing to the credit of the reserve fund, for contingent losses, such amount as the board fixes,

not less than the amount required by law, a dividend of the earnings in an amount to be determined by the board, shall be semiannually placed to the credit and entered in the pass-books of the members, in proportion to their average investments, except that borrowing members who have elected to take a rebate of interest, shall only be allowed dividends on the amount of their dues paid in during the preceding year, and the settlement shall be annual instead of semiannual. The residue of said earnings may be carried as undivided profits, to be used as other profits in such way as the board under the law may direct; provided, that the total undivided profits shall at no time exceed three per cent of the assets.

ARTICLE XI.

Amendments to the Constitution.

This Constitution may be amended at any annual or special meeting, by a two-thirds vote of the members present in person or by proxy. But the amendment must be offered in writing and posted in the place of meeting for at least two weeks.

BY-LAWS.

President and Vice-President.

No. 1. The President shall preside at all meetings and enforce strict order. He shall see that all requirements by the board from purchasers and borrowers are fully complied with, and shall cause all mortgages to be recorded after their acceptance by the board, for which service he shall receive a fee of \$2, and for each separate encumbrance upon the security offered, that is settled or canceled under his supervision, he shall receive a fee of \$1, to be paid by the mortgagor. He shall appoint all committees not otherwise provided for, and shall give bond for the faithful performance of his duties in such sum as the board may fix.

No. 2. The Vice-President shall perform all the duties devolving on the President, during his absence, and shall receive the same compensation when acting in his place. He shall give a bond for the faithful performance in such amount as the board may fix.

Treasurer.

No. 3. The Treasurer shall receive all moneys paid to the Finance Committee at every regular meeting, and give his receipt therefor in return, and said moneys shall be deposited by him in the depository and in the name of the Association at the next business day after said meeting.

When ordered by the board he shall deliver all books, papers, moneys, etc., in his hands, to any Treasurer *pro tem.* appointed by the board. He shall return to the Secretary, semiannually at the close of each term, all checks paid during the term, and shall report at each meeting of the board the receipts, disbursements and balances in the treasury. For the faithful discharge of his duties he shall give a bond in such amount as the board may require.

Secretaries.

No. 4. The Secretary shall keep an accurate account with all the members and depositors, and keep the minutes of all meetings of the members and of the Board of Directors. All the money which is paid to the Association must be received by the Finance Committee in the presence of the Secretary, and said committee shall be responsible for the correctness of the same, and shall deliver it immediately, upon receipt, to the Treasurer. At every meeting he shall inform the Association of the amount of money received and the amount paid out. He shall keep his books on the double-entry system. He shall, under a penalty of \$2, see that the insurance policies on mortgaged property are renewed at the proper time. He shall give notice in one English and one German paper of the annual meeting, and shall preserve all official books and papers, and deliver them over to his successor in office. He shall always be prepared to inform the Board of Directors as to the state of the financial affairs of the Association, and shall submit every six months all his books and papers to an Auditing Committee; and at the close of every six months he shall make a complete report of the condition of the finances, and shall credit to each member the amount of his dividend declared. All examinations and investigation of claims are to be conducted by him in conjunction with the board. For the faithful discharge of his duties he shall give to the Association a bond in such amount as the board shall fix.

No. 5. The Assistant Secretary shall assist the Secretary, as he may direct, and in the absence of the Secretary shall perform his duties.

Attorney.

No. 6. The Attorney shall draw the papers, report in writing on the title of all real estate offered as security, and answer all questions on law propounded by the board. For the faithful performance of his duties he shall give bond in such sum as the board may fix.

No. 7. The Attorney shall receive from each applicant for a loan as a compensation for examining title, making mortgage, and reporting on title on any one piece of property, the sum of \$10. If more than

one title has to be examined, additional fees shall be charged, as the board may fix.

Committees.

No. 8. The Appraising Committee shall consist of three Directors, whose duty it shall be to visit the premises and ascertain the cash value of all real estate offered as security, and report the same in writing to the board at its next regular meeting; they shall each receive from the applicant a fee of \$1.50, if the property is within the city limits, and if outside the city, a reasonable compensation, according to the estimation of the board, to be paid by the borrowing member. But no member of the committee will be entitled to a fee, unless he personally visits in committee the security offered.

No. 9. The Finance Committee shall consist of two or more Directors, whose duty it shall be to superintend the collection of all moneys and credits of the Association, and shall be responsible for all moneys collected under their supervision, until passed over to the Treasurer; they shall have a general supervision of all finances of the Association, and report to the board at every regular weekly meeting, previous to adjournment, the amount of the receipts of the evening. The chairman of said committee shall act as cashier.

No. 10. The Auditing Committee shall consist of two or more competent persons, elected by the board at the close of each semiannual term. Every six months this Committee shall audit and examine all books, accounts, securities and vouchers of the Association, and make a written report thereof to the board, and pass-books must be handed in for audit during April and October, when demanded. For their services they shall receive a compensation, to be fixed by the board.

Fines.

No. 11. Each borrowing member who neglects to pay his weekly assessments and dues shall be fined 10 cents per share, or fraction thereof, per week.

No. 12. If a member, through sickness, becomes unable to pay, he must notify the Board of Directors. The Finance Committee shall investigate the condition of such member, and on their recommendation the board shall give him a reasonable time to make future payments.

No. 13. All members of the Board of Directors, neglecting the meetings of the Association, shall be fined 25 cents for each absence; upon those who have books or papers in their charge a fine of \$1 shall be assessed for each non-attendance. Sickness or absence from the city shall exempt them from fine. In case the Secretary should be unable to attend the meetings, he shall be required to deliver or cause to be

delivered the books and papers of his office to the Finance Committee; a neglect thereof shall subject him to a fine of \$5.

No. 14. The board shall have the power to remit fines for good cause.

Transfers.

No. 15. Any non-borrowing member may transfer his shares by notifying the Secretary in writing and paying a fee of 50 cents.

No. 16. A borrowing member who has sold his property, may, with the approval of the board, have the purchaser substituted as a member by transferring his share or shares to such purchaser.

Withdrawals.

No. 17. If a member desires to withdraw all or any part of his credits on undrawn shares from the Association, he shall give due notice of his intention in writing to the Secretary, and the amount of his dues paid in, with all profits credited, less all fines, interest and amounts due, shall be refunded to him in his turn according to priority with other applicants for money, unless the Board of Directors for good cause decide otherwise.

Same in Case of Death.

No. 18. The legal representatives of a deceased non-borrowing member may enter upon his rights and obligations, or may withdraw, in which case they shall receive whatever may be due them, as soon as the immediate receiver of money has been paid off.

Survivorship Accounts.

No. 19. Both stock and deposit accounts may be issued, carried and paid as joint and survivorship accounts, in the names of two or more persons, whether adults or minors, when the joint owners have given to the Association a joint order in substance as follows:

"We, the undersigned owners of joint. deposit account No. . . . in the Hillsdale Loan and Building Company, of Cincinnati, Ohio, do hereby agree and jointly authorize and order said Company to pay any and all of the credits now or hereafter on said account, on the order of any one or more of us, both before, after and notwithstanding the death or other incapacity of any one or more of us. And such payment shall be a valid acquittance of said Company as against any one at any time concerned.

Signed this. day of. 19.

.....

Amending By-Laws.

No. 20. Amendments to the By-Laws may be made at any time by a two-thirds vote of all the members of the board; but all proposals to amend shall be made in writing at a regular meeting of the board at least one week before action thereon.

Statistics of Building and Loan Associations, 1920-1921.

From the Report of the Comptroller of the Currency for 1921, p. 175.

	State.	Number of associations.	Total membership.	Total assets.	Increase in assets.	Increase in membership.
1	Pennsylvania ¹	2,785	1,000,000	\$475,000,000	\$74,202,493	164,252
2	Ohio.....	775	973,168	462,790,288	81,311,585	148,893
3	New Jersey.....	939	426,264	238,908,007	39,637,974	71,700
4	Massachusetts.....	202	296,411	174,042,652	19,166,652	34,411
5	Illinois ¹	700	269,000	137,000,000	8,748,995	16,500
6	New York.....	267	249,174	115,779,799	15,320,785	40,175
7	Indiana.....	358	212,300	109,721,337	15,498,139	1,599
8	Nebraska.....	74	119,131	77,939,337	12,171,277	6,263
9	Michigan.....	75	99,765	50,976,795	8,568,679	7,666
10	California.....	87	42,420	47,851,294	9,476,962	4,192
11	Louisiana.....	68	80,000	46,183,575	11,669,244	17,094
12	Wisconsin.....	97	87,000	43,641,142	12,079,058	19,152
13	Missouri.....	181	71,494	40,863,108	7,484,719	12,214
14	Kansas ¹	90	82,500	39,100,000	5,989,770	6,641
15	Kentucky ¹	119	75,000	35,000,000	4,542,714	8,000
16	District of Columbia.....	21	45,625	30,125,125	2,579,192	1,276
17	Oklahoma.....	62	46,343	28,590,423	11,171,622	17,875
18	North Carolina ¹	145	58,000	26,000,000	2,547,229	4,879
19	Washington.....	43	55,854	20,175,163	6,840,410	7,989
20	Arkansas.....	49	28,000	17,896,788	3,132,964	1,308
21	Iowa.....	68	49,000	17,654,390	3,343,963	3,304
22	Minnesota.....	63	23,904	11,354,433	1,730,303	3,304
23	Colorado.....	42	22,000	10,986,445	1,915,411	4,000
24	West Virginia ¹	50	27,700	10,700,000	825,435	1,710
25	Maine.....	39	17,548	9,248,960	1,198,030	2,064
26	Rhode Island.....	8	14,680	8,126,856	997,063	1,810
27	Connecticut.....	30	15,615	7,097,282	1,137,217	2,115
28	South Carolina.....	139	15,920	5,777,432	331,508	970
29	Oregon.....	10	17,611	5,200,457	629,068	6,511
30	New Hampshire.....	25	11,067	4,700,629	588,085	1,958
31	South Dakota.....	16	6,515	4,006,312	99,940	170
32	Montana.....	21	16,156	3,667,486	1,100,289	8,780
33	North Dakota.....	12	7,325	3,656,795	744,825	1,490
34	Tennessee ¹	12	5,800	3,500,000	385,765	750
35	Texas.....	11	3,960	3,251,391	598,891	1,695
36	New Mexico.....	13	4,100	1,707,200	319,333	745
37	Arizona.....	4	3,100	1,173,812	93,288	230
38	Vermont.....	7	1,499	548,613	137,615	572
	Other States.....	916	374,170	189,981,000	24,780,128	37,140
	Total.....	8,633	4,962,919	2,519,914,971	393,294,581	673,593

¹ Estimated.

² Estimated, including Maryland and Alabama, heretofore reported separately.

The progress which the local building and loan associations have made since accurate statistics have been available in 1893 until the present time is reflected in the following figures:

Year.	Number of associations.	Total membership.	Total assets.	Yearly increase or decrease in assets.	Annual per cent increase in assets.	Annual average due each member.
1893.....	5,598	1,349,437	\$473,137,454	-----	-----	\$350.62
1895.....	5,770	1,545,129	579,627,765	\$106,490,311	22.50	375.13
1896.....	5,776	1,610,300	598,388,695	18,760,930	3.23	371.60
1897.....	5,872	1,642,179	600,130,037	2,741,342	1.46	366.05
1898.....	5,879	1,617,837	600,135,739	1,994,248	1.46	370.95
1899.....	5,438	1,512,685	531,866,170	118,869,569	13.04	384.65
1900.....	5,356	1,495,136	571,366,628	110,499,542	11.80	382.15
1901.....	5,302	1,539,593	565,387,966	15,978,662	11.04	367.22
1902.....	5,299	1,530,707	577,228,014	11,840,048	2.09	377.09
1903.....	5,398	1,566,700	579,566,112	2,338,098	.40	369.92
1904.....	5,265	1,631,046	600,342,386	20,776,274	3.59	368.07
1905.....	5,264	1,642,327	632,344,257	29,001,871	4.37	351.98
1906.....	5,316	1,699,714	673,129,193	43,784,941	6.95	399.94
1907.....	5,424	1,839,119	731,508,446	58,379,248	8.67	397.74
1908.....	5,599	1,920,257	784,175,753	52,667,307	7.19	408.37
1909.....	5,713	2,016,651	865,332,719	72,156,996	9.20	424.63
1910.....	5,869	2,169,893	931,867,175	75,534,456	8.82	429.45
1911.....	6,099	2,332,829	1,030,637,031	98,819,856	10.60	441.81
1912.....	6,273	2,516,936	1,137,600,399	106,963,361	12.37	451.98
1913.....	6,428	2,836,423	1,248,479,139	110,878,491	9.74	440.16
1914.....	6,616	3,103,935	1,357,707,900	109,228,761	8.75	437.41
1915.....	6,806	3,334,899	1,484,205,875	126,497,975	9.31	445.05
1916.....	7,072	3,568,432	1,598,628,136	114,423,261	7.79	447.98
1917.....	7,269	3,838,612	1,769,142,175	170,514,039	10.66	460.37
1918.....	7,484	4,011,401	1,898,344,346	129,202,171	7.30	473.23
1919.....	7,788	4,236,326	2,136,620,399	238,276,044	12.02	491.39
1920.....	8,633	4,962,919	2,519,914,971	383,294,581	18.49	507.75

¹ Decrease.

Brotherhood of Locomotive Engineers Co-operative National Bank of Cleveland.

A BANK STATEMENT YOU CAN UNDERSTAND.

Statement of Condition at the Close of Business, October 3, 1922.

Resources.

Cash on Hand and in Banks	\$2,925,245.78
This is actual currency and silver in our vaults and money on deposit with the Federal Reserve Bank or other banks payable on demand.	
Loans on Demand	2,266,528.27
Loans to individuals and corporations payable when we ask for them, secured by stocks, bonds and notes of greater value than the loans.	
Other Loans and Discounts	3,267,263.78
This is short time paper discounted for customers, payable in less than three months on the average and largely resting on stocks, bonds, and bills receivable.	
U. S. Government, State and Municipal Bonds	2,784,279.39
Bonds of the United States Government, State of Ohio and various municipal issues for which there is a steady demand.	
Other Bonds and Securities	4,249,471.76
These are bonds of Industrial Corporations, Public Utilities and Foreign Governments, and in most cases secured by a first mortgage or high grade securities, their market value being greatly in excess of figures at which we carry them.	
U. S. and Municipal Bonds Pledged	654,529.28
This represents bonds borrowed and pledged with the Treasurer of the State and County, and the Board of Education to secure funds on deposit in this bank.	
U. S. Bonds to Secure Circulation	800,000.00
U. S. Bonds owned and deposited with the U. S. Treasurer to secure Bank Notes issued in this bank's name.	
Interest Earned, Uncollected	159,149.34
This represents interest that has accrued to date on all loans, bonds, securities, etc., but not yet collected.	
Furniture and Fixtures	55,635.79
Investments in vaults, safes and other equipment after making a deduction on account of depreciation.	
5 per cent Redemption Fund with U. S. Treasurer	40,000.00
We are required by law to keep on deposit with the Treasury Department at all times 5 per cent of our circulation (\$800,000.00). This is to take care of mutilated currency coming in to the Treasurer's hands for redemption.	

\$17,202,103.39

Liabilities.

Capital Stock	\$1,000,000.00
Amount invested by stockholders in the shares of this bank.	
Surplus and Undivided Profits	200,089.00
This represents amount earned from all sources to date, including interest on loans and discounts, interest on bonds, commissions, exchange and collections, etc.	
Notes in Circulation	777,400.00
This is actual currency, in five dollar denominations, bearing the name of this bank, which we are obliged to redeem on demand.	
U. S. and Municipal Bonds Borrowed	654,529.28
Bonds borrowed from the Brotherhood of Locomotive Engineers and used to secure deposits of public moneys.	
Reserve for Interest, Taxes, Etc.	48,594.68
This represents interest accrued on time deposits, savings deposits, and estimated taxes on circulation, personal property, income, etc.	
DEPOSITS { Savings	\$11,939,705.80
Demand	2,581,784.63
This includes deposits subject to check, savings deposits requiring 30 days' notice before withdrawal and deposits left for stated periods of from six to twelve months.	

\$17,202,103.39

The above statement does not include those assets of friendliness and helpfulness which this bank has in the personnel of its officers, board of directors and employees. The dividends paid to our patrons from these assets are service and satisfaction. The ideal of this bank is to lose no opportunity of serving the people in those channels that only a bank can serve them, thereby helping to promote prosperity and happiness.

"Profits Shared With Savings Depositors."

Advertisement of Brotherhood of Locomotive Engineers Co-operative National Bank of Cleveland.

Capital Stock\$1,000,000.00
Surplus \$135,000.00

CO-OPERATION

SERVICE

Owned by members of the Brotherhood of Locomotive Engineers and managed by expert bankers.

COMMERCIAL

SAVINGS

BONDS

TRUSTS

Four per cent interest paid on savings if funds are in the bank 30 days or more.

Two per cent paid on commercial accounts if over \$500.

At close of business November 1, 1921, this bank issued the first savings dividend check ever paid by a National bank, thus paying over 5 per cent on savings our first year. The second savings dividend checks were issued July 1, 1922.

Co-operation.

Everybody is talking co-operation. The Brotherhood of Locomotive Engineers Co-operative National Bank is practicing co-operation.

For fifty-nine years the B. of L. E. has been a fraternal organization. It is truly co-operative. It makes no profit from any of its enterprises except its fourteen-story office building in Cleveland, which has been highly successful.

With millions of resources of our own to invest, with many more millions of our members and divisions to invest, and with no banks owned by labor in this country, our Grand Convention on two separate occasions authorized the organization of a bank.

The by-laws of the bank limit dividends on the capital stock to 10 per cent. The stockholders can never receive more than 10 per cent. The remainder of the earnings go first to the building up of a surplus required by law, which surplus will increase the security of the depositors;

and second, the balance of the earnings will be distributed to savings depositors and trust funds on a *pro rata* basis. In other words, the depositors of the bank are partners in the bank. They share in the earnings. That is one of the principles of co-operation. Co-operation recognizes that those who make a business profitable should share in the profits they create.

That is why the motive of the bank is co-operation.

That is why the motto of the bank is service.

Application for Shares of Stock in Brotherhood of Locomotive Engineers Co-operative National Bank of Cleveland, Ohio.

Application No.

To:

Warren S. Stone and William B. Prenter,
Organizing Committee:

I hereby subscribe for.....shares of capital stock of "Brotherhood of Locomotive Engineers' Co-operative National Bank of Cleveland, Ohio" (or for so much of such subscription as may be allotted to me), of the par value of one hundred dollars (\$100.00) each, and agree to pay for same one hundred dollars (\$100.00) a share and ten dollars (\$10.00) a share additional for the creation of a banking surplus fund to meet the requirements of the law.

Payments to be made as follows: Sixty dollars (\$60.00) a share within thirty (30) days from date of application, and the balance in five (5) equal monthly installments (to be paid on or before the fifteenth day of each month) of ten (\$10.00) dollars for each of the shares I subscribe for.

I agree with the provision in the by-laws of the corporation that the maximum annual dividends shall not exceed ten per cent (10%) on the capital stock and that any surplus earnings may be distributed as the Board of Directors may decide in carrying out the co-operative purposes which underlie the organization of the bank.

I agree to the regulation that ownership of capital stock is to be confined to members in good standing in the Brotherhood of Locomotive Engineers and officers of the bank during their tenure of office; and further agree that should I desire to dispose of any stock allotted to me, I will first offer it to a purchasing committee hereafter created by the Board of Directors of the bank, at a price to be determined by the book value of such shares, ascertained from the capital, surplus and undivided profits of such corporation.

I further agree that in case my connection with the Brotherhood of Locomotive Engineers is severed, or in case of my death, my stock will be tendered to such purchasing committee which shall acquire it for resale.

I further agree to the regulation that such stock shall only be transferred by the officers of the bank, in accordance with this agreement, which is for the safeguarding of the purposes for which the bank is organized.

I constitute William B. Prenter, my attorney-in-fact, to enter this subscription in the stock book which may be opened for the purpose.

Name
 Street
 P. O. Address
 State or Province
 Date, 1920

(All remittances should be in the name of William B. Prenter, F. G. E.)

The Joint Commission of Agricultural Inquiry on Farm Credit.
Sixty-seventh Congress, First Session, House of Representatives Report
No. 408, Part II, pp. 8-9.

The present banking system consists of the Federal Reserve System, including about 8,210 national banks; the State banking systems, which include about 20,000 State banks, of which 1,630 are members of the Federal Reserve System; the Farm Loan System, with its farm loan bank in each State; the joint stock land banks, of which there are 22; the farm loan associations, which are part of the Federal Farm Loan System, and private farm mortgage and cattle loan companies.

The National and State banking systems are the principal agencies furnishing short-time credit to the farmer. These State and National banks, together with the Federal Farm Loan System and the private farm mortgage companies, also furnish the great bulk of the long-time credit to farmers. Short-time credits, however, are largely limited to credits for periods of six months or less, owing to the fact that paper of longer maturity than six months for agricultural purposes is not eligible for rediscount with the Federal reserve banks. Longer time credit can only be secured on the basis of farm mortgages, and, even if it were possible to do so, it would not be wise to make farm mortgages the basis of credit for production or marketing purposes.

It is evident that there is a gap between the short and long-time credit furnished by these banking agencies which should be filled in some way.

The commission believes that the credit problem of the farmer can best be met by adapting existing banking agencies to his credit requirements. In meeting these requirements there is no reason why, without destroying their utility for the purposes for which they were originally created, all of the banking agencies of the country cannot be used by adapting them to the farmers' requirements. These requirements are for credit of sufficient maturity to make payment possible out of the proceeds of the farm. This means a credit running from six months to three years, depending upon the character of the commodities to be produced and marketed. In the case of crops six months may be in some instances sufficient, but in the case of live stock three years may be required.

The commission proposes to meet these requirements by authorizing any Federal land bank through a separate department created in it under restrictions, limitations, conditions, and regulations adopted by the Farm Loan Board to rediscount paper on which money has been advanced to or used by the farmer for agricultural purposes having a maturity of not less than six months or more than three years at rates of discount to be fixed by the Farm Loan Board for any incorporated national bank, State bank, trust company, savings institution, or live-stock loan company. In addition the commission deems it desirable to permit the Federal land banks to make loans direct to co-operative associations of farmers organized under State laws for the purpose of marketing staple agricultural products when such loans are secured by warehouse receipts upon such products.

The notes or obligations representing loans or discounts by the Federal land banks are to be converted into short-time debentures and sold to the public in the same way as farm-loan bonds are now sold.

It is proposed further that notes taken or discounted by a Federal land bank shall be eligible for rediscount with any Federal reserve bank, when such loans have reached a maturity of less than six months. In addition, any Federal reserve bank is authorized to buy and sell the debentures issued by the Farm Loan Board to the same extent and in the same way as they now buy and sell farm-loan bonds.

The Farm Loan Primer.

Circular No. 5 (Revised) of the Federal Farm Loan Board.

History and Purposes of the Federal Farm Loan Act.

1. Q. *What are the general purposes of the Federal Farm Loan Act?*

A. To lower and equalize interest rates on first-mortgage farm

loans; to provide long-term loans with the privilege of repayment in installments through a long or short period of years, at the borrower's' option; to assemble the farm credits of the Nation to be used as security for money to be employed in farm development; to stimulate co-operative action among farmers; to make it easier for the landless to get land; and to provide safe and sound long-term investments for the thrifty.

2. Q. *When did this act become a law?*

A. It was passed by Congress June 28, 1916, and was signed by President Woodrow Wilson July 17, 1916, and became a law immediately.

3. Q. *When were the 12 Federal land banks located?*

A. In December, 1916.

4. Q. *When were the banks established?*

A. In March, 1917.

5. Q. *On what date was the first farm loan association chartered, and the first loans authorized?*

A. March 27, 1917.

Organization and Administration.

6. Q. *What, briefly, is the machinery for the application of the Farm Loan Act?*

A. There are three parts, as follows: (1) The Federal Farm Loan Board, consisting of four members, named by the President, and the Secretary of the Treasury as chairman. (2) The 12 Federal land banks and a large number of joint stock land banks located in various sections of the country. (3) The many national farm loan associations organized and controlled by the borrowers themselves, each made up of 10 or more farmers.

The Farm Loan Board.

7. Q. *What are the duties of each of the above-named organizations?*

A. The Federal Farm Loan Board exercises supervision over the entire system. The Federal and joint stock land banks make the loans and issue their bonds or debentures to investors. The national farm loan associations are organizations of borrowers, and through them applications for loans are made to the Federal land banks only.

8. Q. *Who were the members of the first Farm Loan Board?*

A. The first board was made up as follows: William G. McAdoo, Secretary of the Treasury, chairman; George W. Norris, Farm Loan Commissioner; Herbert Quick; W. S. A. Smith, and Charles E. Lobdell.

9. Q. *Who are the present members and when do their terms of office expire?*

A. Hon. Andrew W. Mellon, Secretary of the Treasury, is chairman; Charles E. Lobdell, Farm Loan Commissioner, term expires 1926; W. S. A. Smith, term expires 1922; R. A. Cooper, term expires 1924; and W. H. Joyce, term expires 1928.

The Federal Land Banks.

10. Q. *What determined the location of the banks?*

A. The Federal Farm Loan Board located these banks with a view to serving most advantageously the farm loan needs of the country.

11. Q. *Where are the 12 Federal land banks located?*

A. The following table shows the number designating each Federal bank district, the States included in the district, and the cities in which the banks are located:

District number.	States.	Federal land bank at—
1	Maine, Massachusetts, Vermont, New Hampshire, Rhode Island, Connecticut, New Jersey, and New York	Springfield, Mass.
2	Pennsylvania, West Virginia, Maryland, Delaware, Virginia, and District of Columbia.	Baltimore, Md.
3	North Carolina, South Carolina, Georgia, and Florida	Columbia, S. C.
4	Indiana, Ohio, Kentucky, and Tennessee	Louisville, Ky.
5	Louisiana, Mississippi, and Alabama	New Orleans, La.
6	Illinois, Missouri, and Arkansas	St. Louis, Mo.
7	North Dakota, Minnesota, Wisconsin, and Michigan.	St. Paul, Minn.
8	Wyoming, Nebraska, South Dakota, and Iowa	Omaha, Nebr.
9	New Mexico, Kansas, Colorado, and Oklahoma ...	Wichita, Kans.
10	Texas	Houston, Tex.
11	California, Nevada, Utah, and Arizona	Berkeley, Calif.
12	Idaho, Washington, Montana, and Oregon	Spokane, Wash.

Persons desiring to get in touch with any of these banks should address them in this style: "Federal Land Bank of Springfield, Springfield, Mass." The banks are equipped with all the necessary literature to accommodate inquirers.

12. Q. *Who manages directly each of the 12 Federal land banks?*

A. A board of five directors appointed by the Federal Farm Loan Board. This organization is temporary, and will continue in effect only until after the Federal farm loan bonds now held by the United States Treasury are disposed of, when a permanent organization will be effected, composed of directors in part elected by farm loan associations and in part appointed by the Farm Loan Board.

13. Q. *What is the capital stock of a Federal land bank?*

A. Each bank was organized with a capital stock of \$750,000, which, under the terms of the act, is automatically increased by 5 per cent of each loan made. The capital stock of the 12 Federal land banks on May 1, 1922, was \$31,475,165.

14. Q. *Does this stock pay dividends?*

A. Yes. The banks are on a dividend basis and have paid dividends on stock held by national farm loan associations.

15. Q. *Explain how, after a bank lends its original capital, it gets additional money to lend to farmers.*

A. By depositing the mortgages which it has taken as security for farm loan bonds, and then selling these bonds. There is no limit to the capacity of a bank to serve the needs of farmer-borrowers so long as it can sell its bonds.

16. Q. *May these Federal land banks accept deposits or do a general banking business?*

A. They may accept deposits from the United States Government, and may also accept deposits from national farm loan associations to be applied to the purchase of farm loan bonds. They cannot do a general banking business.

17. Q. *Who may borrow from Federal land banks?*

A. Owners of farm land who are at the time, or shortly to become, engaged in the cultivation of the farm mortgaged.

The National Farm Loan Associations.

18. Q. *What is a national farm loan association?*

A. A local corporation chartered by the Federal Farm Loan Board.

19. Q. *How many farm loan associations have been incorporated?*

A. On June 1, 1922, there had been chartered 4,559 associations.

20. Q. *Of what does such a corporation consist?*

A. Ten or more farmers whose applications for loans amount to not less than \$20,000.

21. Q. *What should a person do who desires to make a loan?*

A. He should apply for membership in the nearest farm loan association.

22. Q. *What should he do if there is no national farm loan association within easy reach?*

A. He should communicate with the Federal land bank of the district, which will advise him what to do.

23. Q. *What is the relation of the national farm loan association to the system?*

A. It is the door through which the farmer-borrower enters into the

benefits of the system. It is the co-operative agency through which loans are initiated, through which the application of their proceeds is supervised, through which collections are made, and generally through which the local interests of borrowers are served.

24. Q. *May any but farmers and landowners join a national farm loan association?*

A. Prospective farmers, tenants, or farm laborers, who are about to purchase land for their own use, may apply for membership in a national farm loan association, and may become members when their loans are closed.

25. Q. *Who is the executive officer of a national farm loan association?*

A. The secretary-treasurer.

26. Q. *What are the duties of a secretary-treasurer?*

A. It is the duty of the secretary-treasurer of a national farm loan association to act as custodian of its funds; to collect, receipt for and transmit to Federal land banks payments of interest, amortization installments or principal arising out of loans made through the association, when requested to do so by the national farm loan association; to act as custodian of the securities, records, papers, certificates of stock and all documents relating to the conduct of the affairs of the association; to make quarterly reports to the Federal Farm Loan Board, and at the request of the Board to furnish information regarding the condition of his association; to assure himself that the loans made through national farm loan associations are applied to the purposes for which they were sought and to report any failure of any borrower to comply with the terms of his application; and to ascertain and report to the Federal land bank the amount of any delinquent taxes on land mortgaged and the name of the delinquent.

He is the agent for the local association in its relations with the Federal land bank. His responsibility increases in proportion to the growth of his association. The growth of the association depends largely upon the care with which the secretary-treasurer conducts its business.

27. Q. *Does the secretary-treasurer receive a salary?*

A. He may receive compensation, the amount to be fixed by the directors of the local association, subject to the approval of the Farm Loan Board. The secretary-treasurer may serve without salary if he will.

28. Q. *What determines the voting strength of each member of the local association?*

A. Each member has one vote for each \$5 share of stock. A man who borrows \$1,000 would necessarily have \$50 worth of stock, or 10

votes. But no one stockholder may have more than 20 votes, no matter how much stock he may own. In the organization meeting each person has one vote irrespective of the amount he expects to borrow.

29. Q. *May any but borrowers belong to these local loan associations?*

A. No; membership is confined to stockholders, and borrowers only may be stockholders.

30. Q. *May a local loan association increase its membership after it is organized, and in operation?*

A. Certainly. It may admit new borrowers, each of whom must subscribe to stock equal to 5 per cent of his loan.

31. Q. *Is there any limit to the number that may be members?*

A. No.

32. Q. *What is the amount of the bond required of a secretary-treasurer?*

A. If the total loans of a farm loan association do not exceed \$50,000 his bond should be \$3,500. For each \$10,000 of loans additional \$600 should be added to the amount of the bond; but no bond for over \$10,000 will be required.

33. Q. *What sort of bond is required?*

A. A bond with corporate security.

Terms and Conditions of Loans.

34. Q. *What is the rate of interest under the Farm Loan Act?*

A. The maximum rate is 6 per cent.

35. Q. *Is the rate of interest the same in every land bank district?*

A. Yes.

36. Q. *Why is the rate uniform when each Federal land bank issues its bonds separately?*

A. Because the bonds of each bank are guaranteed by every other bank and are therefore equally secure.

37. Q. *If, in the future, the interest rate is lowered, will the present borrowers be obliged to continue at the present rate?*

A. Yes; until their loans have run for five years, when they may make new loans at the prevailing rate.

38. Q. *How does the farmer pay his interest and principal payments?*

A. In equal annual or semiannual installments throughout the entire period of the loan.

39. Q. *May a borrower pay off his loan before maturity?*

A. He may pay all or any part at any interest-paying date after the mortgage has run five years.

40. Q. *You say a farmer who borrows is required to buy stock of his*

local association equal to 5 per cent of his loan? What becomes of this stock?

A. It is held by the local loan association as collateral security until the farmer pays off his debt. Then the money is returned him. In the meantime his stock is entitled to receive its proportionate share of any dividends which the association may declare.

41. Q. *Who gets the dividends on this stock while it is held as collateral security by the local loan association?*

A. The borrower.

42. Q. *What does the local association do with the money which the borrower pays for his stock?*

A. The association uses it to buy stock in the Federal land bank. This is done to increase the Federal land bank's capital in order that it may make more loans.

43. Q. *Is there any liability on the part of a borrower for the debts of other borrowers?*

A. Yes; each national farm loan association guarantees every loan made to its members. Should a loss occur on the foreclosure of a mortgage, the association will be called upon to meet the deficiency, and if the association has not the funds, the members may be assessed an amount equal to the amount of their stock.

44. Q. *What are the probabilities of such an assessment?*

A. If loans are conservatively made no loss can reasonably occur that would call for this 5 per cent liability. This illustrates the necessity for careful management of the local loan association by providing for the exclusion of bad risks and for the conservative valuation of lands.

45. Q. *Then it is not true, as many have supposed, that one member of a national farm loan association is placed under unlimited liability for the debts of his associates?*

A. No. Each member is liable to the extent shown above, the personal liability being 5 per cent of his loan, and that to be called only when the association has become insolvent. In such a case the borrower may lose all of the association stock owned by him and in addition thereto he may be liable for all or part of an additional 5 per cent of the amount of his loan.

46. Q. *How may an association become insolvent?*

A. Through bad loans or mismanagement only.

47. Q. *So there is no danger of the borrower losing the value of his stock in the national farm loan association or being called upon to pay an additional amount equal to 5 per cent of the amount of his loan if the land of every member that is taken as security can be sold at all times for an amount equal to his indebtedness?*

A. Absolutely none.

48. Q. *So the local association is responsible for the installment payments to be made by its members as they mature?*

A. Yes.

49. Q. *What is the maximum and minimum amount of loans?*

A. No farmer may borrow more than \$10,000 or less than \$100. No national farm loan association may start with less than \$20,000 in applications for loans.

50. Q. *Suppose by drainage or clearing I increase the value of land on which I have secured a loan. May I then secure an increased loan?*

A. Yes; to the extent of one-half of the added value.

51. Q. *Suppose a prospective borrower cannot raise the 50 per cent of the purchase price of land; would he be permitted to execute a second mortgage to come due while the amortized loan was being paid off?*

A. Yes. With a long-time amortized loan as a prior lien it ought to be much easier to place a second mortgage than with a short-time straight mortgage, because the amortized mortgage is gradually reduced every year, and the required payments thereunder may be made so small as not to menace the ultimate security of the second mortgage. But the law does not allow the Federal land banks to lend on second mortgage. The borrower must find some other lender to carry the second mortgage.

52. Q. *Who passes on the value of the land offered as security?*

A. The local national farm loan association has a loan committee of three members for this purpose, who must agree upon the valuations. Then, after the report of the loan committee has been sent with the application for loans to the Federal land bank, the land will be visited and appraised by an appraiser appointed by the Federal Farm Loan Board.

53. Q. *What percentage of the value of the security may be borrowed?*

A. Up to 50 per cent of the appraised value of the land plus 20 per cent of the appraised value of the permanent insured improvements. That is, if your land is appraised at \$15,000, you would be entitled to borrow \$7,500; and if your improvements are worth \$5,000, you could borrow \$1,000 more, or \$8,500 in all.

54. Q. *For what purposes may the money borrowed be expended?*

A. The money may be spent to discharge existing indebtedness; for the purchase of land, and for the purposes specified in the law, such as the purchase of live stock, or for any kind of productive improvements, for fertilizer, for needed buildings, drainage, and for proper equipment.

55. Q. *What is the object of these limitations?*

A. It is the policy of the law to develop agriculture and benefit the farm as well as the farmer.

56. Q. *Will the borrower pay for abstracts of title?*

A. Yes.

Amortization.

57. Q. *What is meant by "amortization"?*

A. Amortization is the term applied to the process of paying off an indebtedness by installment payments of a fixed amount, which includes interest and a part of the principal, throughout a period of years.

58. Q. *Are all loans under the Federal Farm Loan System made on this plan?*

A. Yes.

59. Q. *How long may these loans run?*

A. From 5 to 40 years, at the option of the borrower.

60. Q. *A payment of the interest and 1 per cent per year applied on the principal will wipe out the debt in how many years?*

A. In about 35 years.

61. Q. *What term of years is recommended by the Farm Loan Board?*

A. In most cases 35 years, because this term allows the debt to be paid off by annual or semiannual payments equal to $6\frac{1}{2}$ per cent a year on the principal, but loans may be made for any period from 5 to 40 years.

62. Q. *How often will the borrower make payments—annually or semiannually?*

A. Annually or semiannually, but the semiannual system has been adopted as the standard.

63. Q. *What would be the semiannual payment on a \$1,000 mortgage for 35 years at $5\frac{1}{2}$ per cent interest?*

A. Thirty-two dollars and fifty cents.

64. Q. *Will the payment of \$32.50 every six months completely wipe out the mortgage and discharge it?*

A. Yes.

65. Q. *If a borrower gives a 35-year mortgage, has he always the right to pay it off before maturity?*

A. He may pay it all or in part on any interest-paying date after it has run five years. But in case of prepayments it is recommended that he always make them on the basis of taking up one or more of his future payments on the principal.

66. Q. *Why is he not allowed to pay it off before five years?*

A. Because the borrower is using money which the Federal land bank has secured by the sale of bonds which cannot be redeemed for five years.

67. Q. *Then, really, it is to the advantage of the borrower to have this limitation?*

A. Yes; because the permanency of the investment adds to the attractiveness of the bonds, and anything which has that effect lowers the interest rate of the bond and gives the farmer a lower rate.

68. Q. *If the mortgage is made to run for less than 35 years, is not the size of the semiannual payments increased?*

A. Yes. The semiannual payments required to wipe out a \$1,000 debt at $5\frac{1}{2}$ per cent interest in 10 years would be \$65.67; in 15 years, \$49.38; in 20 years, \$41.53; in 25 years, \$37.04; in 30 years, \$34.22. Remember, these are semiannual payments—not annual.

(NOTE.—For a more detailed account of the amortization method of repaying a loan, write to the Farm Loan Bureau for a copy of Circular No. 7.)

Farm Loan Bonds.

69. Q. *You have spoken entirely from the point of view of the farmer borrower. Suppose I have money to invest; how does this system interest me?*

A. The bonds of the Federal land banks ought to be a very attractive investment for you.

70. Q. *Why?*

A. Because they are secure, command a ready market, and are free from all forms of taxation.

71. Q. *Why are they secure?*

A. Because they are secured by first mortgages on farms, the appraised valuation of which is at least twice as great as the amount loaned upon them, and usually more.

72. Q. *Is that all the security there is?*

A. No; the assets of all the 12 Federal land banks are behind the bonds of all banks.

73. Q. *And is that all?*

A. No; they have the further security that the payment of each loan is guaranteed by a farm loan association. Many of the associations are already creating cash reserves against this contingent liability.

74. Q. *So, as a matter of fact, the security back of the bonds is at least twice their face value plus the resources of the 12 Federal land banks plus the indorsement of the national farm loan associations?*

A. Yes; and with the further assurance that the wide distribution of

the security, so unaffected by local conditions in any part of the country, will contribute to the value and stability of the security.

75. Q. *You say the bonds are free of all forms of taxation. Does that include income tax and all forms of State and municipal tax of every kind and character?*

A. Yes.

76. Q. *And is the income of all these bonds also free of taxation?*

A. Yes.

77. Q. *Does the Government guarantee these bonds?*

A. No; but they are issued under the supervision of the Government and cannot be issued until the Government authorities have passed upon the securities and satisfied themselves that each dollar of bonds issued is secured by at least \$2 worth of land, and each bond contains on its face a certificate of its regularity signed by the Federal Farm Loan Commissioner, a Government official.

78. Q. *In what denominations are these bonds issued?*

A. In \$40, \$100, \$500, \$1,000, and larger denominations.

79. Q. *Are they protected against counterfeiting?*

A. They are engraved by the Government Bureau of Engraving and Printing the same as money is engraved, and will be as carefully protected from counterfeiting as money is protected.

80. Q. *Do the bonds of all banks bear the same rate of interest?*

A. Yes.

81. Q. *Must a bank get authority from the Federal Farm Loan Board to issue bonds?*

A. Yes; these bonds must be secured by Government obligations or first mortgages in at least equal amounts. These mortgages must be first approved as security by the Farm Loan Board, and deposited with a registrar, who is a Government official, and acts as trustee for the bondholders.

82. Q. *What rates of interest do these bonds bear?*

A. The rates at present are $4\frac{1}{2}$ and 5 per cent.

Joint Stock Land Banks.

83. Q. *I have read something about joint stock land banks which may be organized under this system. Please tell me about them.*

A. The act provides that private individuals may organize joint stock land banks, with capital stock of at least \$250,000 each, and consisting of not less than 10 stockholders. One-half of the capital stock must be paid up when the bank starts business and the other half is subject to call. The joint stock land bank has the right to issue bonds after its

capital is fully paid up, just as the Federal land banks do, and it may make loans at a rate one per cent per annum above the rate which its last issue of bonds bears. Joint stock land banks are not permitted to charge over 6 per cent interest.

84. Q. *May a joint stock land bank take a second mortgage?*

A. No; and only first mortgages and Government bonds may be utilized as security for an issue of bonds.

85. Q. *Are loans made under the amortization plan?*

A. Yes.

86. Q. *Does the Federal Farm Loan Board supervise the operation of joint stock land banks?*

A. Yes. These joint stock land banks are private institutions intended for the investment of private capital, but they are supervised by the Board, inspected by its examiners, and their appraisals are under the control of the Federal Farm Loan Board.

Decisions by Farm Loan Board.

87. Q. *What constitutes an "actual farmer"?*

A. An actual farmer is one who conducts the farm and directs its entire operation, cultivating the same with his own hands or by means of hired labor. An owner, to borrow under the Farm Loan Act, must be responsible in every way, financially and otherwise, for the cultivation of his land.

88. Q. *What is the meaning of "equipment"?*

A. Equipment consists of the property used in the conduct of a farm, such as teams, machinery, and many other articles.

89. Q. *What is the meaning of "improvements"?*

A. Anything in the form of beneficial structure, or any useful permanent physical change in the farm tending to increase productive value, such as clearing, tiling, draining, fencing, building, etc.

90. Q. *Has a farm loan association the right to appoint an attorney to draw up abstracts and pay him out of its official funds or should the members of the association handle this matter as individuals?*

A. Each borrower is required to furnish his own abstract and the applicant must stand the expense of preparing this abstract. An association has no right to employ any of its corporate funds to pay for the preparation of abstracts for its members. This must be an individual charge, and if members of an association club together to have this work jointly done, they must do it as individuals and not as an association. Each borrower is free to make his own choice in the selection of an attorney or abstractor, subject to reasonable requirements of the Federal land bank.

91. Q. *May members of a partnership borrow?*

A. Yes; if one or both are farmers and engaged in the cultivation of the land mortgaged. Partners must join severally in executing the mortgage, and one should give the other authority to represent him in the farm loan association, as only one can have membership.

92. Q. *Will the Federal land banks make any charge for examination of abstracts of titles?*

A. The examination of abstracts, when furnished, will be made by the bank's general attorney at its office, and for this examination a reasonable charge may be made. In districts where abstracts are not obtainable except by examination of the records, the borrower will have to bear the cost of such examination.

93. Q. *When a husband and wife execute a joint mortgage should one give the other power of attorney to be the representative in the farm loan association?*

A. Both husband and wife should sign the mortgage, but the one in whose name the title stands should be the member of the association.

94. Q. *What is the basis for appraising lands?*

A. The appraisement of a farm should represent the best judgment of the members of the loan committee as to the value of the land in question, the principal factor being the productivity of the land when used for agricultural purposes, but taking also into consideration the salability of the land and prevailing land prices in that community.

95. Q. *May one man, by owning two pieces of land, become a member of two associations and borrow in excess of \$10,000?*

A. He may become a member of two associations, but the total amount of his loans may not exceed \$10,000.

96. Q. *May an association operate across State lines even if both States are in the same land bank district?*

A. No; no association may designate territory in two States in which loans can be made.

97. Q. *In a general way, what sort of abstract will be required? Must they be prepared by bonded abstractors, or is this a matter for the judgment of the land bank officials?*

A. It is a matter for the Federal land banks to determine. Any abstract of title sanctioned by ordinary sound business usage in the community will be sufficient under this act.

MATERIALS OF BANKING

An Example of Amortization.

From "Killing Off Mortgages," Circular No. 7 (Revised) of the
Federal Farm Loan Board, p. 7.

A loan of \$100 at 6 per cent interest repayable in 33 years by means of semiannual installments of \$3.50,
which includes interest and part of principal.]

Payment No.	Install- ment.	Interest.	Applied on princi- pal.	Princi- pal still unpaid.
1.....	\$3.50	\$3.00	\$0.50	\$99.50
2.....	3.50	2.98	.52	98.98
3.....	3.50	2.97	.53	98.45
4.....	3.50	2.95	.55	97.90
5.....	3.50	2.94	.56	97.34
6.....	3.50	2.92	.58	96.76
7.....	3.50	2.90	.60	96.16
8.....	3.50	2.89	.61	95.55
9.....	3.50	2.87	.63	94.92
10.....	3.50	2.85	.65	94.27
11.....	3.50	2.83	.67	93.60
12.....	3.50	2.81	.69	92.91
13.....	3.50	2.79	.71	92.20
14.....	3.50	2.77	.73	91.47
15.....	3.50	2.74	.76	90.71
16.....	3.50	2.72	.78	89.93
17.....	3.50	2.70	.80	89.13
18.....	3.50	2.67	.83	88.30
19.....	3.50	2.65	.85	87.45
20.....	3.50	2.62	.88	86.57
21.....	3.50	2.60	.90	85.67
22.....	3.50	2.57	.93	84.74
23.....	3.50	2.54	.96	83.78
24.....	3.50	2.51	.99	82.79
25.....	3.50	2.48	1.02	81.77
26.....	3.50	2.45	1.05	80.72
27.....	3.50	2.42	1.08	79.64
28.....	3.50	2.39	1.11	78.53
29.....	3.50	2.36	1.14	77.39
30.....	3.50	2.32	1.18	76.21
31.....	3.50	2.29	1.21	75.00
32.....	3.50	2.25	1.25	73.75
33.....	3.50	2.21	1.29	72.46
34.....	3.50	2.17	1.33	71.13
35.....	3.50	2.13	1.37	69.76
36.....	3.50	2.09	1.41	68.35
37.....	3.50	2.05	1.45	66.90
38.....	3.50	2.01	1.49	65.41
39.....	3.50	1.96	1.54	63.87
40.....	3.50	1.92	1.58	62.29
41.....	3.50	1.87	1.63	60.66
42.....	3.50	1.82	1.68	58.98
43.....	3.50	1.77	1.73	57.25
44.....	3.50	1.72	1.78	55.47
45.....	3.50	1.66	1.84	53.63
46.....	3.50	1.61	1.89	51.74
47.....	3.50	1.55	1.95	49.79
48.....	3.50	1.49	2.01	47.78
49.....	3.50	1.43	2.07	45.71
50.....	3.50	1.37	2.13	43.58
51.....	3.50	1.31	2.19	41.39
52.....	3.50	1.24	2.26	39.13
53.....	3.50	1.17	2.33	36.80
54.....	3.50	1.10	2.40	34.40
55.....	3.50	1.03	2.47	31.93
56.....	3.50	.96	2.54	29.39
57.....	3.50	.88	2.62	26.77
58.....	3.50	.80	2.70	24.07
59.....	3.50	.72	2.78	21.29
60.....	3.50	.64	2.86	18.43
61.....	3.50	.55	2.95	15.48
62.....	3.50	.47	3.03	12.45
63.....	3.50	.37	3.13	9.32
64.....	3.50	.28	3.22	6.10
65.....	3.50	.18	3.32	2.78
66.....	2.87	.09	2.78	.....
	230.37	130.37	100.00	.....

Selected Sections from the Banking Law of New York Governing
Credit Unions.

§450. *Incorporation; Organization Certificate.*

When authorized by the superintendent of banks as provided in section twenty-three of this chapter, seven or more persons employed or residing in the State of New York may form a corporation to be known as a credit union. Such persons shall subscribe and acknowledge and submit to the superintendent of banks at his office an organization certificate in duplicate which shall specifically state:

1. The name of the corporation which shall include the words "credit union."

2. The place where its business is to be transacted. If the condition of membership is employment of its members by a certain individual, partnership or corporation, the place of business of such individual, partnership or corporation may be stated as the place of business of such credit union.

3. The par value of the shares, which shall not exceed twenty-five dollars.

4. The full name, residence and post-office address of each of the incorporators and the number of shares subscribed for by each.

5. The term of its existence, which may be perpetual.

6. The number of its directors which shall not be less than five, and the names and addresses of the incorporators who shall be its directors until the first annual meeting of shareholders.

§453. *General Powers.*

In addition to the powers conferred by the general corporation law, a credit union shall, subject to the restrictions and limitations contained in this article, and in its by-laws, have the following powers:

1. To issue shares to persons qualified for membership.
2. To charge an entrance fee to subscribers for such shares.
3. To charge a reasonable fee for the transfer of its shares.
4. To receive the savings of its members in payment of shares or on deposit.

5. To lend money to its members upon such terms and conditions as the by-laws provide and as the credit committee shall approve, at rates not exceeding one per centum per month, inclusive of all charges incident to the making of such loan.

6. To deposit any moneys received by it and not lent to members, as provided in section four hundred and fifty-six of this article.

7. To borrow money to an amount not exceeding forty per centum of the capital of such corporation, except where the capital is five thousand dollars or less, in which event such credit union may borrow any amount up to two thousand dollars.

8. To reduce its liability to shareholders as provided in section four hundred and sixty-two of this article.

9. To fine members for failure to meet punctually obligations to such credit union.

10. To expel members, as provided in section four hundred and sixty-three of this article.

11. To impress a lien upon the shares and dividends of any member to the extent of any loans made to him and for any dues or fines payable by him.

12. To cancel the shares of any member who withdraws or is expelled, and apply the withdrawal value thereof to the liquidation of such member's indebtedness to the corporation.

13. To hold shares in and make deposits with other credit unions.

14. To invest any moneys received by it and not lent to its members in the securities which are authorized as investments for savings banks by subdivisions one, two, three, four, five and seven of section two hundred and thirty-nine of this chapter.

The Credit Union.

*Written by Roy F. Bergengren for the Credit Union National
Extension Bureau.*

The purpose of this pamphlet.—General extension throughout the United States of the Credit Union, as at present operating in accordance with credit union laws in Massachusetts and North Carolina, might materially assist in the solution of four major problems which concern the people of the United States.

Thrift would thereby be promoted on a national scale.

In cities, such extension would create credit facilities for wage workers at low rates of interest, tending to the elimination of the "loan shark" and of the practice of usury.

In rural districts the credit union would assist materially in the solution of the farmer's short-term loan problems.

Because it concerns itself with units of saving too small, individually, to interest ordinary banking facilities the credit union accumulates capital which would not be otherwise added to the capital resources of the people.

The purpose of this pamphlet is to discuss the credit union, its method of organization, prior history and present status and to present such statistical information as may have a bearing on the possible accomplishment by credit union extension of its four major objectives.

Definition.—A credit union is a co-operative association whose objects are:

1. To promote thrift among its members.
2. To provide its members with credit facilities.¹

In its method of organization, operation and control the credit union is a "bank in miniature," concerned with the *smallest units of saving* and equally *small questions of credit*. The emphasis is upon savings in installments at regular and frequent intervals and the credit union depends, for its success, on creating the *habit of saving* in its members.

Shares and deposits.—The funds of a credit union are accumulated by the issuance of shares which may be paid for in cash or in regular weekly or monthly installments. The installment unit is small, generally ten or twenty-five cents, payable weekly in the average credit union, the insistence being on the regularity of the saving rather than on the individual amount. In addition a shareholder may deposit, the minimum acceptable deposit being again small, in some credit unions a deposit of ten cents being permitted. *The credit union is essentially the bank of small units.*

A considerable total accumulation may result rapidly from such a system. The Telephone Workers Credit Union of Massachusetts, for example, consists of some five thousand of the employees of the New England Telephone and Telegraph Company, telephone girls, linemen, etc. After four years of operation this credit union has present assets of nearly three hundred thousand dollars. St. Ulric, a rural community in the Province of Quebec with a farming population of less than two thousand, has a credit union with assets of \$89,089.

Loans.—From the funds loans are made to members for provident purposes at low rates of interest, repayable on a weekly or monthly installment basis, pro-rated over such period as the credit committee, in each case, may deem wise. Loans are subject to such conditions as regards security, etc., as provided by the rules and votes of the particular credit union and as required by the credit committee.

Valdese Credit Union.—For example, a rural credit union situated in Valdese, North Carolina, had, August 1, 1921, outstanding loans of this character amounting to \$27,242.10. This credit union has ninety-two members and its loans are almost exclusively of the character naturally incidental to the business of farming.

¹ "A Credit Union Primer" by Arthur H. Ham and Leonard G. Robinson.

The Credit Union, Central Falls, located in the city of that name in Rhode Island, has over thirteen hundred members and had outstanding loans, December 31, 1920, amounting to \$412,725.

It is interesting to note that these two credit unions, practically identical in method of organization and operation, serve, in the one case the farmers of a North Carolina village and, in the other, a membership of city dwellers in a typical Rhode Island industrial city.

The Credit Union, La Caisse Populaire, the Raiffeisen and Schulze-Delitzsch Banks and the Peoples Banks.—Before discussing credit union organization and operation in detail it should be noted that the name generally applied to co-operative credit associations of this character in the United States—the credit union—is used in this article as a general designation of such associations wherever found. The relationship between the credit union, La Caisse Populaire and the various systems of Peoples Banks in Europe is clear and their identity of method and purpose in all major details the logical result of the sequence of the development of organizations of this character. The name “credit union” was first applied to institutions of this sort in Massachusetts in the draft of the first law in the United States, providing for general credit union organization prepared by Pierre Jay, then Bank Commissioner of the State and enacted in 1909. Mr. Jay, in the preparation of the draft, consulted with M. Alphonse Des Jardins who, in 1900, had established the first La Caisse Populaire or Peoples Bank in Levis in the Province of Quebec. M. Des Jardins is not only the connecting link between the credit union of the United States and the Co-operative Peoples Bank (La Caisse Populaire) of Canada, which systems are practically identical in all major details, but he is responsible for the application of a system of co-operative credit, which had been long in successful operation in other parts of the world, to conditions as he found them in the Province of Quebec. The system devised by Des Jardins was profoundly influenced by his study, covering a period of fifteen years, of Peoples Banks in Europe, especially the original Raiffeisen rural banks and the similar institutions originated by Schulze-Delitzsch and utilized by wage earners in cities, both of which systems had not only been extensively developed in Germany but had served as models for the organization of similar institutions in many other parts of the world.

Methods of organization similar in the United States.—The difference in credit union laws in the United States is only such difference in detail as would be naturally anticipated from local adaptations of a general law. For example in North Carolina, where the credit union development is rural, jurisdiction vests in the Department of Agricul-

ture. In New York and Massachusetts, where the credit union is primarily industrial in character, they are under the supervision, direction and control of the Commissioner of Banks. No attempt will be made to analyze minor differences in the laws of various States, the description of the method of organization and operation contained herein being based on the Massachusetts experience, as typical.

How a credit union is organized.—It is the purpose of the credit union law to make organization as simple as possible. The Massachusetts law provides that "any seven persons who are residents of the Commonwealth" may petition for a charter. In North Carolina "seven or more persons employed or residing in the state may, etc." *The law contemplates small credit unions.*

The original Canadian credit union at Levis started with capital of twenty-six dollars. It now has total assets, after over twenty years of successful operation, well in excess of a million dollars.

Hearing and first meeting.—In Massachusetts the petitioners are granted a hearing by the Board of Bank Incorporation. If the petition is granted the organizers hold their first meeting and adopt by-laws. A Board of Directors, a Credit Committee and Supervisory Committee are elected at the meeting and certain preliminary details, such as the amount of the entrance fee, the amount of loan which may be made with security and without security, etc., are decided. The Directors then meet and choose, from their own number, a President, Vice-President, Treasurer and Clerk. The by-laws are submitted to the Bank Commissioner for his approval and, as soon as they are approved, the charter is issued and the credit union is authorized thereby to do business.

Fundamental rules.—A credit union has a few fundamental rules which are most important.

Officers cannot borrow.—Officers cannot borrow nor become indorsers for borrowers without a favorable vote of the members in special meeting called for the purpose of passing on the specific loan. The Canadian system is even more strict in this regard and an officer of the credit union cannot borrow from it at all.

A member has a single vote.—A member has one vote, whatever the amount which he may have in the credit union in shares and deposits.

An organization of members.—All funds are derived from the members, loans are made exclusively to members, the management is within the membership and the earnings of the credit union are distributed to the members in dividends on shares and interest on deposits. Dividends and interest paid by the average credit union will compare very favorably with the earnings on deposits in other savings institutions.

Low operating expense.—Overhead expense is kept at a minimum.

Until the credit union is large enough to pay the treasurer or manager, services are gratuitous. Equipment is most modest. Office space is often donated and rent always low; it being the policy of the credit union to do business in unostentatious quarters at the lowest possible expense.

It cost \$235 to run the St. Ulric credit union for a year and less than \$3,000 for all expenses including furnishings, etc., of the Levis Credit Union in 1920, although the total business of the credit union for the year was close to two million dollars. A New York credit union did a business of \$307,000 on a salary payroll of \$750. A smaller New York credit union, with assets of \$21,000 had no payroll at all, operating for a year on a total expense of \$56, which included an item of \$20 for an officer's bond.

Way and manner in which loans are made.—The funds of the credit union are, in the first instance, deposited in some bank designated by the directors to be the depository.

Applications for loans must be signed and must set forth the purpose of the loan and such other detail as a particular credit union may require. The applicant must be a member and, if not a member but eligible to membership, must subscribe to at least one share when the application is filed. If already a member, his shares and deposits in the credit union are additional security for his loan or possibly ample security for it. If he has no holdings in the credit union and the credit committee is otherwise satisfied with him as a prospective borrower the committee will doubtless require that he subscribe to a certain proportional part of his loan in shares so that, as he pays up his loan, he pays into the credit union in addition each week something on the shares to which he has subscribed. The result is that, when his loan is paid up, he also has a substantial number of paid-up shares in the credit union. The application is filed with the credit committee and must be approved by a majority of its members. The terms of repayment, security, etc., are determined by the committee in accordance with the general rules of the credit union and the circumstances involved in the particular case. It is the general practice of Massachusetts credit unions to loan up to fifty dollars without security, if the credit committee is satisfied with the individual credit. Security may be the indorsement of the note by a fellow member, a chattel mortgage, assignment of life insurance, etc. Loans are generally repayable on a weekly basis.

That the judgment of the average credit committee is good is indicated by the official reports. The Levis Credit Union has operated for twenty years without losses from bad loans, having done a business during that period aggregating eight million dollars. The fifth annual report of the Skandia Credit Union of Worcester, Massachusetts, says, "During

these five years it has loaned \$397,309.72 without a loss." The Ste. Marie, Manchester, New Hampshire, with assets in excess of \$700,000 and an experience covering a period of eleven years makes a similar report. The report of the Massachusetts Bank Commissioner for 1920 indicates total loans made during the year of \$3,311,698, which loans were made without appreciable losses.

Classification of loans.—Loans fall within two general classifications:

A. Loans to farmers by rural credit unions.

B. Loans to wage earners by urban credit unions.

A. Rural credit union loans.—The farmers' credit problem inspired the first Raiffeisen bank in Flammersfeld in 1849 and was an acute problem before that time and has been for some time and remains an acute problem in the United States. Farming is a business. Thinking of farming as a business, it becomes obvious that the very nature of the business makes for dependency on credit. Before the farmer can realize any money return from his business operations he must, of necessity, make continuous outlay. Any layman can list a multitude of items of expenditure which the farmer must make as necessarily precedent to income. It is with this credit problem that the rural credit union is most intimately concerned.

The following analysis indicates the service which a small credit union can render in this connection. Between January 1 and July 1, 1920, Carmel Credit Union, one of the thirty-three rural credit unions in North Carolina, loaned \$7,488.50 sub-divided as follows:

For fertilizer	\$2,375
feed and food	523
cows and mules	750
milk truck	350
dues in Milk Association	200
boring a well	100
to hold cotton against sudden drop in price	2,950
college tuition	200

Another analysis of a group of consecutive loans made by a small rural credit union results as follows: total loaned, \$4,385; for fertilizers, \$1,675; live stock, \$815; food and feed stuffs, \$365; labor, \$400; farm machinery, \$75; cows, \$395; auto trucks, \$300; to close loan with Federal Land Bank, \$300; sickness, \$60.

These loans are typical of those made by the North Carolina credit unions. Each loan is a practical solution of some farmer's short-term loan problem. These credit unions are all young in years, and therefore necessarily limited in resources.

It is interesting to note something of the service being rendered by

rural credit unions of somewhat longer standing in the Province of Quebec. Five rural credit unions are taken as typical of the Canadian situation.

<i>Name.</i>	<i>Population.</i>	<i>Assets.</i>	<i>Loans Outstanding.</i>
St. Ulric	1600	\$89,089.47	\$61,322.38
Maria	800	62,313.54	35,477.61
Ste. Euphemie	400	41,446.33	35,572.32
St. Jean des Piles	800	24,442.49	13,819.40
St. Onesime	"small parish"	25,393.45	16,716.40

The significance of these figures is that, in each case, there is a very substantial balance over and above outstanding loans. The quite obvious conclusion is that the credit union, within a given group or community, gradually attains the size which enables it to offer complete credit facilities to all its members. When this point is reached the credit union has solved—completely solved—the small loans problem of its own membership.

It is interesting to note that, according to the Statistical Year Book for the Province of Quebec, 1920, loans are made by Canadian credit unions most frequently for "the purchase of farming implements, live stock, seed-grain and provision by wholesale" while the North Carolina credit union loans most frequently appearing in the records, cover fertilizer, seed, farm machinery and farming implements, mules, horses and other live stock and other purposes which are all essentially of the type natural to farming operations.

Co-operative buying by rural credit unions.—One feature of rural credit union loans is worthy of special mention. In North Carolina there is already considerable co-operative buying by credit union members of the things which they use in common. Farmer A, needing fertilizer in less than a carload lot, combines with Farmers B, C, D and E to buy, through the credit union of which they are all members, a carload of fertilizer, which quantity represents their joint need. They do this by pooling their joint credit, each assuming so much of the joint loan as represents his proportionate part of the fertilizer. Three advantages accrue to each of them from the transaction. They each enjoy the benefit of the wholesale price and the cash discount. Each one has such time to pay back his part of the joint loan as is reasonably required. This is co-operative buying in fact and is applied not only to the purchase of fertilizer but other commodities which farmers use in common.

Elsewhere in this article something of the extraordinary development of rural credit through the European credit unions is indicated. *Enough has been accomplished in Canada and North Carolina to show the pos-*

sible development of rural credit through this plan in the United States.

B. Urban credit union loans.—No better example can be offered of the value of the credit union to the wage worker in the city than is contained in the experience of the City Employees Credit Union of the City of Boston, made up exclusively of municipal employes of the city.

It was organized in 1915 as a result of an investigation conducted by the then Mayor of Boston, James M. Curley. Quoting from a speech delivered by him at the annual meeting of the members of the credit union on November 20, 1917, "This investigation revealed the facts that city employes were being grossly imposed upon . . . the situation among the city laborers was such that on an average over a hundred men lost a half day's pay each week in order to make necessary arrangements with money lenders to withdraw assignments of wages filed against them with the City Treasurer. In addition, these men were being charged interest at the rate of 180 per cent a year on their loans. They were entirely at the mercy of the loan sharks. This condition happily no longer exists." He then outlines the service which had been rendered by the credit union up to that time. According to the 1920 report of the Bank Commissioner this credit union now has assets of \$30,892. It has 914 members and makes loans to such of them as require it at 8 per cent interest per annum and pays a 6 per cent dividend. The condition which formerly prevailed has been entirely eliminated.

While the variety of urban credit union loans is very great there are a few well-defined classes of loans.

Remedial Loans.

There is the remedial loan. Originally the credit union was primarily concerned with loans of this character and they still bulk large in the category of credit union loans. The necessity in such cases is based on sickness, death, a sudden operation to be paid for, a period of unemployment to be weathered, etc. Many of the credit union loans were to free members from the clutches of the loan shark or to relieve him from a multitude of small debts which were resulting in continuous worry and strain.

The Small Business Man.

Many credit unions serve the small business man whose business and credit problems are too small profitably to concern ordinary banking institutions. His place of business may be a push cart and his stock may be entirely depleted at the end of each day but he has credit problems and he may well be the great merchant of to-morrow in the making.

Rehabilitation Loans.

Since the war many credit unions have made loans which might be classified as rehabilitation loans. Many of those who went to war returned to face an entirely new economic situation. Some had lost their jobs. Others could no longer work indoors. Others had found new fields for their efforts. The credit unions have made a great variety of loans growing out of this situation.

Educational Loans.

A father may borrow to assist his son or daughter through technical or normal school. An ambitious wage earner takes an evening course in law or science, etc., and borrows the necessary tuition from the credit union.

Home Buyers.

A member wants to buy a house which can be bought for \$5,000. He can get a bank mortgage for \$4,000. He has \$800 cash of his own. He still needs \$200, which he can borrow of his credit union if the credit committee is satisfied with the security he offers, which may be a second mortgage on the house. More and more the larger credit unions are granting loans of this character, of particular value at a time of shortage of funds for this particular purpose.

Co-operative Buying.

One credit union bought 5,000 tons of coal at 50 cents per ton off the lowest summer price by pooling the joint credit of those of the membership who were in the market for coal, thereby saving them a total of \$2,500 and insuring to its members coal at the lowest available price. The credit unions make seasonable buying for their members possible and encourage the buying of necessities—furniture and clothing, etc.—at cash rather than installment prices, enabling the members to take advantage of special sales, etc.

These are typical of the credit union loans totaling nearly three and a half million dollars made in Massachusetts in 1920.

Record for Honest and Efficient Management.

Honest Management.

There is not a recorded case of stealing from a Massachusetts credit union or malfeasance on the part of any of its officers. No case involving dishonest management of credit unions anywhere in Canada or

in the United States has ever come to the notice of the writer. This fact is the more remarkable when it is considered that some credit unions now have an annual turnover varying from a half million to two million dollars.

Efficient Management.

The capacity of the average credit committee to make correct diagnoses of credit has already been commented upon.

Despite the very difficult conditions which have prevailed for the past year (August, 1920-1921) there has not been a single credit union liquidation in Massachusetts or North Carolina during that period. In fact during the twelve months more new credit union charters have been issued in Massachusetts than the total of the five preceding years and two new credit unions are now in process of organization in North Carolina.

The reason for credit union stability.—The credit union is largely a personal relationship. In this regard the credit union member bears a relationship to his credit union which is, in no sense, analogous to that between the depositor and the ordinary commercial or savings bank. A member of a credit union feels that he is in fact a member of it and that the fact of his membership carries with it a certain responsibility toward his fellow member. He knows the officers. They are neighbors of his, or his co-workers. He had something to do with choosing them and no artificial barriers stand between him and the management. Loans are small and, as they are being repaid in frequent installments, the risk in the individual cases is constantly growing less. In addition it is the experience of credit unions that in the average membership is much good sense and capacity for efficient management.

Every credit union has a guaranty fund made up of the entrance fees, transfer fees, fines for delinquencies in the payment of shares or the payment on loans and a substantial part of the dividends each year, which fund is carefully segregated from the investment funds of the credit union and serves as a guaranty fund against bad loans. The entrance fee is small and is paid on joining. It rarely exceeds 25 cents.

In Massachusetts there are approximately ten thousand borrowers and thirty thousand members of credit unions, the majority of credit union members being savers rather than borrowers.

The surplus and the accumulation of capital.—In addition to the capital accumulated by the credit unions and utilized by them for small loans to members, which loans now include farm loans, real estate loans, loans to small business men, etc., there remains a surplus as soon as the credit union passes the normal total loan requirements of its members.

Generally the law provides that this surplus may be invested in any investment which is legal for savings banks.

The Telephone Workers Credit Union has, for example, almost a hundred thousand dollars in assets over and above its outstanding loans to members, mostly invested in bonds and bank acceptances. One credit union started five years ago with the objective of accumulating \$10,000 to care for the small-loan requirements of its members. It has present assets of \$636,069, of which approximately \$200,000 is invested in bonds and notes receivable and much of the balance in real estate mortgages. The investments of four large credit unions illustrates the situation.

<i>Name.</i>	<i>Assets.</i>	<i>Loans to members.</i>	<i>Investments.</i>
Ste. Marie (N. H.)	\$737,116.22	\$484,617.00	\$224,000.00
Central Falls (R. I.)	607,440.77	412,725.00	160,000.00
Skandia (Mass.)	636,069.77	397,309.72	207,604.37
Levis (Canada)	1,093,508.92	887,277.02	206,231.90

A total of approximately eight hundred thousand dollars in four credit unions is otherwise invested than in loans to members. Lest it be assumed that such a situation might not prevail in the smaller credit unions the following facts are submitted from the 1920 report of four of the Massachusetts credit unions, each of relatively small assets.

<i>Name.</i>	<i>Assets.</i>	<i>Loans.</i>	<i>Investments.</i>
Gilco	\$11,275	\$2,858	\$6,500
Industrial	36,246	23,702	9,996
Whitson	16,838	9,811	4,912
Winthrop	3,484	1,130	1,150

The possible result of the logical development of credit unions. At a credit union conference, held in Boston November, 1917, the then Bank Commissioner, August L. Thorndike, said, "As to what the credit union can do: In the Old World . . . there is a credit union for about every twenty-five hundred people. If we had the credit union system fully expanded in Massachusetts there would be room for 1500 credit unions." On the basis of the present average size of the Massachusetts credit unions in membership and assets such an expansion would mean over six hundred thousand credit union members in the State with assets aggregating almost a hundred million dollars. It has been the opinion of other bank commissioners in Massachusetts that credit union members are saving, by the credit union system, money that would not be saved otherwise. Assuming this to be so, the logical extension of the credit union in Massachusetts alone would result in the accumulation of capital to the extent of a hundred million dollars which would not have been accumulated otherwise, which considerable capital would be

invested in part to meet the credit requirements of some half million of the people of the State with large surpluses remaining for investment in such capital investments as are recognized to be legal for savings banks in the State.

It may be a bit fanciful to try to estimate what would result from the extension of such a system throughout the United States. The resulting accumulation of capital would be counted in billions and the membership would be so large that it is not impossible to imagine the development of thrift as a national characteristic of the American people as a result.

President Taft's opinion.—In 1912 President Taft initiated an investigation of agricultural credit systems in operation in certain European countries. As a result of the preliminary report rendered by his investigators he wrote to the governors of the various States on October 1, 1912, in part as follows:

"A very good law has been enacted by the State of Massachusetts allowing the incorporation of credit unions which should furnish an example for the other States. Their establishment is generally a matter of State legislation and encouragement, their organization and management wonderfully simple, as the European experience shows, and their success is practically inevitable where the environment is congenial and where proper laws are passed for their conduct."

A part of the accompanying report reads "Personal credit in agricultural Europe is obtained usually by means of the co-operative credit associations. They are also used by artisans and small trades people in towns and cities. With their aid poverty and usury have been banished, sterile fields have been made fertile, production has been increased and agriculture and agricultural science raised to the highest point."

In Belgium in 1909, 458 of these institutions, with a membership of 25,762, had outstanding four million dollars of loans.

In France 2,983 local banks of this character with a membership of 133,000 farmers had \$2,622,241 capital and a record of over twenty millions of dollars of operations. There are nearly 6,000 of these banks in Austria. The membership was 725,666 and the loans ran over eighty-six million dollars.

In Italy 690 banks had furnished reports, showing a working capital of over \$170,000,000.

In Germany there was one such bank for every 1,600 of the population and the total business done was nearly five billion dollars.

Relationship to the banking system.—The relationship of the credit union to the established banking system is well described in a pamphlet issued by the State of Massachusetts entitled "Credit Unions." "The history of the credit union movement shows that these bodies

become feeders and collecting agencies for savings banks. Operating in a personal manner in small local fields or groups they can *teach their members the desirability of saving in a way the less personal savings banks cannot do*. Any portion of their funds not lent to the members is authorized by law to be deposited in savings banks. Credit unions do not in any case become competitors of co-operative or savings banks: *they open up new fields of thrift* and encourage people to save who have not hitherto had savings accounts."

Conclusion.—No one would seriously question the value of *thrift promotion*, particularly at this time when we are beginning to realize something of the losses incidental to waging a world war and the sober problems involved in deflation and the readjustment to new conditions. If the credit union can assist in any material measure to make thrift a national characteristic of the American people it is thereby justified, although that be the only service which it can render.

When the credit union concerns itself with the creation of *credit facilities for wage earners* and, in the process, has to do, most effectively, with the elimination of usury it is again vitally affecting a national problem. It was seriously urged before a committee of the Massachusetts legislature in 1921 that 42 per cent per annum is the scientific rate at which the money lender can do business at a fair profit and that the alternative to such a rate is the practice of usury in defiance of law. In support of this contention evidence was introduced that in fifteen States the present legal rate on small loans is 42 per cent per annum.

Without admitting the truth of the contention it is still obvious that the fact of a legalized rate of 42 per cent admits the existence of usury and indicates that the practice of usury can be finally eliminated not by regulation of the small-loan offices but by the substitution of some human agency which will make credit for wage earners possible at reasonable rates of interest.

In this connection it is interesting to note that, while loans made by Massachusetts credit unions in a single year have been increasing from a half million to nearly three millions and a half, the number of licensed money lenders in the State has decreased from 127 to 59 and the capital invested in the private small-loan business from \$7,842,000 to \$1,847,000. While this fact is not due entirely to the credit union, the relationship of a well-established credit union system to the small-loan problem is obvious.

So with *the farmer's short-term loan problem*. It is a vital problem of national importance. Eventually some solution of it will be attained whereby every farmer who deserves credit will be able to get it to the extent of his legitimate demands. Meanwhile we have the facts. The

Raiffeisen rural banks began to solve this problem for farmers in various parts of Europe over a half century ago. In Canada there are rural credit unions in small towns and villages which not only completely solve the small-loan problems of their members but have a surplus for other investment. North Carolina has made a beginning and demonstrated, in a substantial way, that the credit union may be applied to organizations of farmers in the United States. Is it not quite possible that the credit union, based on the principle of co-operation and self-help, may, without subsidy or Government intervention, be the real solution of the farmers' credit problem wherever the problem exists in the United States?

The *accumulation of new capital* is a by-product of thrift. The facts show that the credit union first accumulates a sufficient fund to care for the credit requirements of its members and that it then is naturally concerned with the investment of its surplus. While, as has been stated, it is a bit fanciful to imagine the Massachusetts system extended to its logical extent, with over a half million members and assets of nearly a hundred million dollars, yet similar development has occurred in various parts of Europe. If it be possible to carry such development to all parts of the United States it is conceivable that, in the process, the American people would become a thrifty people with accumulations of capital in credit unions which would add materially to their capital resources.

If the credit union can accomplish any one of its four objectives or can materially aid in such accomplishment, it contains great possibilities of value to the people of the United States.

How can such extension be accomplished?—Such extension is possible through the enactment of a credit union law, similar in its general terms to the credit union laws now in successful operation in Massachusetts, North Carolina, New York, Rhode Island and New Hampshire, in each of the other States of the United States.

Suggested Readings on Chapter XVIII.

Moulton, H. G.—Financial Organization, Chapters XXVII and XXVIII.

Herrick, M. T.—Rural Credits.

Wiprud, A. C.—The Federal Farm Loan System in Operation.

Wright, I.—Bank Credit and Agriculture.

Nourse, E. G.—Agricultural Economics, Chapters XIII and XIV.

Putnam, G. E.—The Land Credit Problem.

Dexter, S.—Building and Loan Associations.

Cf. Chapter XX.—Cattle Loan Companies.

Questions and Problems on Chapter XVIII.*Building and Loan Associations.*

1. Why have building and loan associations been more successful in the United States than other forms of co-operative credit?
2. What, in addition to interest, does a loan of \$5,000 from the loan and building company cost the borrower?
3. If 6 per cent is earned on loans, how long would it take for a share in the Hillsdale Loan and Building Company to mature?
4. How can the building and loan association afford to pay more on savings deposits than a savings bank?
5. How do you explain the territorial distribution of building and loan associations? Try North and South, East and West, agricultural or industrial, native or immigrant population.

The Co-operative Bank.

6. Is the 10 per cent limitation on dividends wise in view of the changing book value of the stock due to the accumulation of surplus?
7. How do you explain the large percentage of savings deposits in the Brotherhood's Bank?
8. Why should the stockholding be restricted to members of the Brotherhood?
9. Assuming that the bank pays as much interest to its depositors as other banks do, why should they receive a share in the profits?

Federal Farm Loan System.

10. What are the costs to a man who wished to borrow \$1,000 on his farm?
11. What are the advantages of the amortization plan from the standpoint of security?
12. Even if the bonds are not callable for ten years, what is the objection to loaning for less than five years?
13. What will be the effect on farm land values if the mortgage rate is lowered? How will this affect the prospective purchaser of land?
14. What liability does a farmer assume when he joins a farm loan association?

15. Why bother with local associations? Why not lend direct to the farmer?

16. Why not lend to the farmer money to pay off indebtedness, no matter how incurred?

17. How much of a shrinkage in value would it require to imperil the security of the Federal farm loan bonds?

18. In order to meet the housing shortage, why should not a system of tax-free bonds secured by mortgages on homes be adopted?

19. Is the element of the varying risk in different parts of the country adequately taken care of by limiting the loan to 50 per cent of the value of the farm?

20. Some local farm loan associations were formed by a group of borrowers and now they refuse to take in new members. Can you see any reason for their refusal?

CHAPTER XIX.

FINANCING FOREIGN TRADE.

How Imports Are Financed.

The letter of credit is usually used to finance imports. It enables the seller to draw a draft on a bank instead of on an individual. Such a draft then has a wide market. The exporter can get his payment immediately after the shipment of the goods, and the importer can get the goods on a trust receipt and sell or manufacture them before he has to reimburse the bank. The bank takes a contingent liability. If the customer does not pay, the bank must; but before it grants the letter of credit, it makes sure of the credit of the customer and often gets collateral security from him.

How Exports Are Financed.

Exports are generally financed by a letter of credit, or an authority to purchase, arranged by the importer; by having the draft of the exporter on the importer discounted at the exporter's bank; or by an advance of 70 to 80 per cent on the security of the exporter's draft, obtained from the exporter's bank. Documents are used, their purpose being to make sure that the goods will be available as security. The principal documents are the bill of lading, the insurance policy or certificate, the invoice, and the hypothecation certificate.

Institutions for Financing Foreign Trade.

In addition to the aid which commercial banks and the Federal reserve banks give to foreign trade, assistance is given by two other types of institutions:

1. Companies which sell debentures to secure funds to loan for the promotion of foreign trade.
2. Companies which accept drafts under letters of credit, and which deal in acceptances.

Such companies may be organized under Federal laws or under State laws. State institutions which agree to supervision by the Federal Reserve Board can have national banks as stockholders.

Materials on Chapter XIX.**The Application for Letters of Credit.**

*From the Federal Reserve Bulletin, vol. 7, pp. 1170-1174
(October, 1921).*

In the previous articles dealing with letters of credit, reference has at times been made to the application. This ancillary document is essential in the issuing of commercial credits and so is of interest to both banker and merchant, since it forms the basis for the contractual relations between these two parties. The present study will describe its use and set forth a comparative analysis of the various expressions found in the applications issued by American banks. Eighty-five different sets of forms were examined, and, as in the case of the letter of credit, little uniformity was found in the content of the applications of American banks. Since the publication of the article in the *Federal Reserve Bulletin* of February, 1921, pages 158-171, which reviewed the leading cases on commercial credits, British and American courts have rendered decisions bearing directly upon the terms of the application for a letter of credit and the credit itself, and these opinions will be cited in this survey.

An applicant for a letter of credit may transmit his request to the bank by telephone, telegraph, or letter. The bank which has been asked to issue the credit usually insists that the importer submit his requisition in a formal document, known as an application for a letter of credit. This instrument has several uses. It supplies the bank with information for analyzing the nature of the transaction. Since the application for a letter of credit is the same in nature as the request for a loan, the bank must understand fully the extent of the risk which it is asked to assume. It is also essential to know the tenor of the drafts and the nature of the import, for these conditions will affect materially the eligibility and therefore the marketability of the bills created by the shipment of the goods. If the terms of the credit are approved by the officers of the bank, the application then serves a third purpose in furnishing the facts necessary for filling out the letter of credit. In this connection it is well to note that the issuing bank considers only the data presented in the application for a letter of credit and does not regard itself bound by the more detailed terms stated in the contract of sale between buyer and seller. [See *Maitland v. Chartered Mercantile Bank of India, London and China* (38 Law Journal, 363); *Oriental Banking Corporation v. Tippet & Co.* (Buchanan's Reports, South Africa, p. 152); *Frey & Son v. Sherburne Co. and National City Bank*

(184 N. Y. Supp., 661); *American Steel Co. v. Irving National Bank*, 266 Fed., 41.] In one way, the interest of the importer is safeguarded by a formal application, as this document presents definitely the conditions which the bank must observe in issuing the credit and in paying the drafts drawn by the exporter.

An application for a letter of credit may be addressed directly to the bank by one of its own customers, or it may be presented indirectly by a correspondent bank acting in behalf of its clients. This institution is usually an inland bank which has no foreign department of its own, and so transmits the request of its customer to a metropolitan bank with facilities for issuing foreign credits.

As an illustration of an application for a letter of credit, the following form is presented:

Date

.....

DEAR SIR: { I } hereby request you to open by { cable } an irrevocable letter
 { We } { mail }

of credit upon the following terms and conditions:

For account of in favor of
 (applicant requesting credit) (foreign)

..... up to an aggregate amount of
 shippers) (amount in words)

available by drafts at { sight } drawn on
 { date } (name of bank and city)

Accompanied by the following documents:
 Cross out documents not required.

Full set of negotiable ocean bills of lading made out to the order of
 bank.

Commercial invoice.
 Consular invoice.
 Marine insurance policy or certificate.
 War risk insurance policy or certificate.
 Certificate of
 Certificate of
 purporting to evidence and cover shipment from
 to of { % } invoice cost of
 { full } (name of commodity)

{ c. i. f. }
 { f. o. b. } (place)

Bills of lading to be dated not later than, and
 unless specifically stated otherwise herein, bills of lading in the form of "received
 for shipment" may be accepted.

{ Marine } insurance to be effected by { me } under blanket policy No.
 { War risk } { us }

issued by
 (shipper)

This credit is { to be confirmed } by Unless
 { not to be confirmed } (name of foreign bank)

mentioned to the contrary, it is understood that part shipments may be made

under this credit. Furthermore, unless stated herein to the contrary, in case shipments are to be made in stated periods, you are expressly authorized in the event of the failure to ship in any designated period, to accept drafts drawn under said credit for shipments made in any period or periods subsequent to the period in which payment or shipments shall not have been made.

Remarks:
 {^I_{We}} hereby agree to sign on demand, and deliver to you, an obligation for such credit, in the form now used by you, the provisions of which are agreed to as defining your rights and {^{my}_{our}} obligations.

.....

This form has been suggested by the committee on uniform credit instruments appointed by the Bankers' Commercial Credit Conference of New York. The application contains all the necessary provisions and will serve as a basis for discussion in the present article. From this instrument it is seen that an application contains the following elements: (1) Request for letter of credit; (2) description of drafts; (3) description of documents; (4) description of shipment; (5) description of merchandise; (6) statement of expiration date.

1. **Request for letter of credit.**—The essential feature of any application is the address in which the importer asks the bank to issue a credit. In the above form, the importer requests the bank to open an irrevocable letter of credit. An analysis of other applications indicates an extensive use of the word "issue." A distinction may be drawn between "open" and "issue," in that the former by implication would permit the notifying of the credit to the beneficiary through a second bank, while the latter would limit the bank to the transmitting of its own obligation to the recipient of the credit. The same difference is found in the applications which request banks to establish "a credit" or to furnish "your credit." As indicated above, a credit may be opened by cable or by mail. If by cable, the communication is usually forwarded to the beneficiary through a correspondent bank which possesses the correct test words. When credit letters are sent by mail they are generally given by the issuing bank to the importer, who in turn sends them to the recipient. A considerable variation is also found in the description of the credit which the bank is requested to open. In the above form the bank is instructed to open an "irrevocable" letter of credit.

In some other forms of application the bank is requested to open simply a "credit." This expression is quite indefinite and therefore unsatisfactory, for it does not furnish the bank with sufficient data in that it leaves uncertain the nature of the credit desired by the importer.

The term "documentary" appears in a number of forms, but this expression is unnecessary, since commercial credits provide for the payment of drafts only if accompanied by shipping documents.

The application forms show considerable confusion in the use of the terms "irrevocable" and "confirmed." A distinction between these two terms is recognized in the above form by the clause which permits the importer to indicate whether he wishes the credit to be further confirmed. When a credit is confirmed it is so notified to the beneficiary through the agency of a second bank. In this form the importer may specify the bank which is to confirm the credit, but as a rule this selection is left to the bank issuing the credit. This institution must then exercise due care in choosing a solvent bank for confirming the credit.

2. **Description of drafts.**—After stating the request for the letter of credit, the application then indicates the number, amount, and tenor of the drafts to be drawn by the accreditee. In the form above, the amount is so described as to permit the beneficiary to receive payment by drawing either one draft, or even several bills if he so desires. It is quite necessary to allow the exporter this choice, for he may find it difficult to forward his goods entirely in one consignment, but instead he must effect partial shipments. The amount to which the exporter may draw his drafts is usually specified as a stated amount of dollars or foreign money. When such terms as "about" or "approximately" are used in referring to the amount of the drafts, the accreditee is allowed a margin of 10 per cent above this sum in drawing his bills. The tenor of the drafts will depend upon whether the beneficiary is receiving a cash or an acceptance credit, and so the drafts will be made either at sight or for such periods of time as 3 and 6 months. To a large extent the tenor of the draft is limited to 90 days, so as to render the bill eligible for rediscount with the Federal reserve banks.¹ The extent of the credit is not always expressed in terms of money, but may also be limited by the quantity of goods. For example, an application may request the bank to issue a credit which permits the beneficiary to draw his drafts covering shipment of a certain number of tons of a commodity.

3. **Description of documents.**—This part of the application is defined with utmost care. The shipping documents constitute the main assurance of reimbursement to a bank in financing foreign trade. The most important shipping document is the bill of lading. It may be classified according to negotiability or to carrier. In the first place, straight bills are consigned to a definite party, and so are nonnegotiable,

¹ Federal reserve banks can now purchase bills running six months.

while order bills are negotiable, for they may be freely indorsed by the holder. According to carrier, bills of lading may be classified as follows: (1) Railroad, when transported by an inland railway; (2) ocean, when carried by a vessel; (3) through, when shipped both by rail and steamer or on different navigation lines. The nonnegotiable or straight bill of lading is made payable in the name of the consignee. Railroad bills of lading seldom appear in foreign trade, since ocean bills are generally required. As Chicago, St. Louis, and other inland cities are gradually entering the field of financing foreign trade, through shipment bills of lading are now being regarded as acceptable documents.

It is also necessary for a bill of lading to be "clean" or free from any notations which qualify or limit the responsibility of the carriers. Steamship companies often make a practice of stamping upon bills of lading expressions which qualify the condition of the merchandise which they are carrying. For example, these notations have reference to the rusting of metals, the leakage of barrels, or the breakage of boxes. Banks are naturally unwilling to negotiate drafts accompanied by bills of lading containing these qualifying expressions.

During the past year widespread consideration has been given to the question whether a bill of lading offers assurance of the actual placement of the goods on board a vessel. This controversy arises from the lack of a clear legal conception of the term "shipment." American courts have given different interpretations to this expression. In the case of *Mora y Ledon v. Havemeyer* (121 New York, 179), shipment was defined as actual delivery on board a vessel, while *Goldenberg v. Cutler* (189 Appellate Division, 489), held that shipment merely implied the surrender of goods to the carrier. The latter view has found favor among American business men and as a result "received for shipment" or "received for transportation" bills of lading have been generally recognized as acceptable documents. This view finds support in *Marlborough Hill v. Cowan* (Law Reports, Appeal Cases, 1921, vol. 1, pp. 444-457). In this case the court drew no distinction between a bill of lading which described the goods either as "shipped on board" or "received for shipment." On this point the decision states that "there can be no difference in principle between the source, master or agent acknowledging that he has received the goods on his wharf or allotted portion of quay, or his storehouse awaiting shipment, and his acknowledging that the goods have been put over the ship's rail."

This opinion was controverted by the King's Bench Division in July, 1921, in the case of the *Diamond Alkali Export Corporation v. Bourgeois*. The litigation arose over the refusal of the importers to pay drafts accompanied by a bill of lading which stated that the goods

had been received "to be transported by the steamship *Anglia* . . . or failing shipment by said steamer in and upon a following steamer." This expression is in common use in exporting goods from American ports. Nevertheless, the King's Bench Court refused to recognize this document as a true bill of lading. In its decision the court referred to *Scrutton and Mackinnon on Charter Parties*, where a bill of lading is defined as "a receipt of goods shipped on board a ship, signed by the person who contracts to carry them or his agent, and stating the terms on which the goods were delivered to and received by the ship." The court thereupon drew a distinction between a receipt for goods actually shipped on board a particular vessel and a receipt for goods which at some future time are to be shipped on board either a particular vessel or an unnamed vessel which will sail at a later date. The court therefore refused to recognize this document as a true bill of lading, but as a "mere receipt for goods which at some future time and by some uncertain vessel are to be shipped." It is therefore highly essential that American banking and commercial interests shall arrive upon a settled definition of the term "shipment" and agree upon the acceptance of a received-for-shipment bill of lading.

The application also furnishes the necessary details regarding insurance. In addition to marine insurance, letters of credit and therefore applications, still require the carrying of mine-risk policies as a safeguard against loss from floating mines. The applicant for a credit must specify whether the insurance is to be taken out by the shipper or by another party. Application forms seldom refer to the name and place of the insurer or the amount of the policy. This matter is usually covered by the contract between the importer and the issuing bank, which states that the insurance companies must be satisfactory to the bank and that the amount shall be adequate.

Applications for letters of credit and likewise the letters themselves have drawn no distinction between the insurance policy and the insurance certificate. It has been common practice for insurance companies to grant open policies which permit the issuing of certificates in the place of the original policies. Justice Bailhache, in *Wilson Holgate & Co. (1920, 2 King's Bench Division)*, makes the following statement: "It must be borne in mind that in dealing with certificates of insurance I am not referring to American certificates of insurance, which stand on a different footing and are equivalent to policies being accepted in this country as policies." However, Justice McCardie, in the case of the *Diamond Alkali Export Co. v. Bourgeois*, regards a certificate of insurance as an unacceptable document. The court claims that the certificate does not contain the terms of the insurance which are to be found only

in the original policy, and therefore it is impossible to learn from the certificate whether the policy has been issued in the recognized and usual form. The court therefore held that the certificate is not a policy and regards it "as an ambiguous thing; unclassified and undefined by law." The case of *Diamond Alkali Export Corporation v. Bourgeois* expresses views on the bill of lading and marine insurance certificate which are quite contrary to the opinions long accepted by legal thought and commercial usage. This fact is fully appreciated by the presiding judge, who closes his decision with the following remarks: "It may well be that this decision is disturbing to business men. It is my duty, however, to state my view of the law without regard to mere questions of convenience."

In addition to the bill of lading and marine insurance policy or certificate, the application also requires the importer to describe the other documents in the commercial set. This includes the commercial and consular invoices, and minor documents, such as certificates of inspection, weight, health, and customhouse declarations.

4. **Description of shipment.**—Most applications call for both the place of origin and destination of the shipment in the expression "from — to —." The port of origin is an essential factor in such commodities as coffee or spices, for it may determine the quality of the goods. On the other hand, the insertion of this condition in a letter of credit may at times impede negotiation of the drafts. For example, owing to a port strike or embargo order, the exporter may be unable to secure cargo space from the port mentioned in the credit and may therefore find it necessary to ship his goods from a second point. Banks would probably be reluctant to negotiate the exporter's drafts, because the conditions of the credit had not been observed in this particular. [See *Brazilian and Portuguese Bank (Ltd.) v. British and American Exchange Banking Corporation* (18 Law Times, p. 823); also *Federal Reserve Bulletin*, February, 1921, p. 161.]

The applicant is sometimes required to indicate the route over which goods are to be shipped in order to allow him some control over the time of the shipment and the freight rate.

5. **Description of merchandise.**—Applications usually make only brief mention of the merchandise, for it is against the interest of the bank issuing the credit to overload it with a detailed description of the imports. A number of applications permit the importer to describe such details concerning the goods, as quantity, quality, packing, marks, and numbers. In interpreting these conditions, the banks are given wide latitude and they are permitted to refuse payment of drafts if the documents are not in strict conformity with the terms of the credit. This

principle has recently been upheld in the case of the International Banking Corporation *v.* Irving National Bank, cited in the United States District Court, Southern District of New York, on May 10, 1921.

6. **Date of expiration.**—The applications used in this study express the expiration date of the letter of credit in the following way: (1) Date of draft; (2) date of shipment; (3) date of bill of lading; (4) date of credit.

These terms need not be further analyzed, as they have already been studied in a previous article. (See *Federal Reserve Bulletin*, April, 1921, p. 412.) These expressions have reference to irrevocable letters of credit rather than revocable, forms which are subject to immediate cancellation. In connection with this subject it may be interesting to note that a recent British decision in "*Cape Asbestos Company v. Lloyd's Bank*" upheld the right of a bank to cancel an unconfirmed, revocable letter of credit any time even without notice to the beneficiary.

From the above review it is evident that there is a lack of agreement between the legal conception and business practice regarding commercial credits in foreign trade. These differences can be reconciled by a clearer definition of the terms used in financing foreign trade and the acceptance of standard forms for the application, contract, and the various types of letters of credit themselves.

Forms Used in Foreign Trade.

THE UNION TRUST COMPANY

CLEVELAND, OHIO, U.S.A., 192

No. _____

£ _____

PAY AGAINST THIS CHEQUE (DUPLICATE UNPAID) OUT OF FUNDS DUE US TO THE ORDER OF

_____ THE SUM OF

STERLING

TO

LLOYDS BANK Limited

_____, England

VICE PRESIDENT
ASST. SECRETARY
FOREIGN DEPT

STERLING BANKERS' CHECK.

THE UNION TRUST COMPANY
CLEVELAND, OHIO, U.S.A.
CAPITAL AND SURPLUS OVER \$33,375,000

Exchange for

_____ 19__

_____ days after _____ of this **FIRST**

of Exchange. Second, of same tenor, and date, unpaid.)

Pay to the order of _____

Value received, and charge the same to account of _____

To _____

_____ Sample

Nº _____

S.D. Childs & Co. 137 So. Clark St. Chicago

Exchange for

_____ 19__

_____ days after _____ of this **SECOND**

of Exchange. First, of same tenor, and date, unpaid.)

Pay to the order of _____

Value received, and charge the same to account of _____

To _____

_____ Sample

Nº _____

S.D. Childs & Co. 137 So. Clark St. Chicago

BILL OF EXCHANGE.

F 446

Credit No. _____

Hibernia Bank & Trust Company

Capital and Surplus, \$4,500,000.00

Foreign Department

New Orleans, La., _____ 19____

Gentlemen:

We hereby authorize you to value on _____, for account
of _____
up to an aggregate amount of _____
available by your drafts at _____
against shipment of _____ to _____
Insurance _____

Bills of Lading for such shipments must be made out to the order of the Hibernia Bank & Trust Company, of New Orleans, unless otherwise specified in this credit.

CONSULAR INVOICE AND ONE BILL OF LADING MUST BE SENT BY THE BANK OR BANKER NEGOTIATING DRAFTS DIRECT TO HIBERNIA BANK & TRUST COMPANY, NEW ORLEANS, UNDER ADVICE TO _____

The remaining documents must accompany the drafts drawn on _____

The amount of each draft negotiated, together with date of negotiation, must be endorsed on back hereof.

We hereby agree with bona fide holders that all drafts drawn by virtue of this Credit and in accordance with the above stipulated terms shall meet with due honor upon presentation at the Office of _____, and proceeds will be paid at _____ if drawn and negotiated prior to _____

DRAFTS UNDER THIS CREDIT MUST BEAR UPON THEIR FACE THE WORDS:

Drawn under _____

Credit No. _____ Dated _____ 19____

HIBERNIA BANK & TRUST COMPANY

COMMERCIAL LETTER OF CREDIT.

Circular Letter of Credit

No 0000

Continental and Commercial National Bank

OF CHICAGO.

Chicago, Ill. U.S.A. _____
Gentlemen!

We beg to introduce to you
_____ say
in whose favor we have opened a credit for £ _____
up to the aggregate of which amount _____ is authorized to
draw demand drafts on the

Bank of Scotland, 19 Bishopsgate Street Within, London.

Each draft is to be plainly marked as payable under Continental and Commercial National Bank's Letter of Credit No. _____ 0000

We engage that such draft shall meet with due honor in London, if negotiated within _____ months from this date, and request you to buy them at the rate at which you purchase demand drafts on London, and collect your charges if any, from the bearer hereof.

The amount of each draft must be endorsed hereon, and this Letter, when exhausted, should be cancelled and attached to the last draft drawn!

W. _____
with our Letter of Indication No. _____
for identification! _____

We are, Gentlemen,
Yours very respectfully,

Continental and Commercial National Bank of Chicago.

To Messieurs:
The Banks & Bankers named in
our Letter of Indication No. _____

CIRCULAR LETTER OF CREDIT.

Specification
of payments made to the bearer of this Letter

Date when paid	Paid by	Amount in letters	Amount in figures

REVERSE SIDE OF CIRCULAR LETTER OF CREDIT.

Form 1 Form adopted by the
New Orleans Clearing House Association

APPLICATION AND TRUST RECEIPT

New Orleans, La., _____ 19____

_____ hereby make application to withdraw, on the terms and conditions of the subjoined TRUST RECEIPT, the certain documents hereinafter described, which said documents and the property represented thereby are pledged with you to secure advances made to _____ on _____ obligations, dated _____

for one or both of the following purposes, viz.:

First, for delivery, of the property represented by said documents, to

(Name of steamship or railroad)

for shipment to _____

(Destination)

Second, for substituting said documents for warehouse receipts or other documents representing and describing the identical property, to be obtained from _____

(Name of warehouse, etc.)

Said documents to be withdrawn are, viz.:

Signature _____

TRUST RECEIPT

New Orleans, La., _____ 19____

Received in trust from _____

the bills of lading, press or warehouse receipts, or other documents or securities described in the foregoing application, held by said Bank as collateral pledged to secure advances made to the undersigned, and in consideration thereof, the undersigned hereby expressly agrees to pay over to said Bank or its assigns, on demand, the proceeds of the sale of the property described in said documents, or should the amount of said proceeds exceed the entire indebtedness to said Bank, in principal and interest, the undersigned expressly agrees to pay over to said Bank or its assigns, on demand, a proportion thereof, equal to the full amount of said entire indebtedness, in principal and interest.

It is stipulated that the payments herein contemplated shall be specifically applied against the identical advances secured by the aforesaid property.

In the event that the undersigned withdraws said documents for the purpose of substituting them for warehouse receipts or other documents, representing and describing the identical property pledged, it is expressly agreed that said new documents shall be delivered to said Bank or its assigns within one (1) day from the receipt thereof by the undersigned.

In either or both of the above cases it is expressly agreed that this delivery is being temporarily made to the undersigned for convenience only, without novation of the original debt, or giving the undersigned any title to said property and the undersigned is given possession thereof solely as trustee for said Bank, and as such to receive the avails thereof or the documents therefor for account of the said Bank.

It is further stipulated, that the undersigned shall not, under any circumstances whatsoever, repledge the property withdrawn under the terms of this TRUST RECEIPT, or, use or sell said property, so withdrawn, for any other purpose than that of paying the indebtedness for the security of which the said property was pledged to said Bank.

(Any violation of the terms and conditions of this TRUST RECEIPT is made a felony by Act No. 9, of 1914, printed in full on the back hereof.)

Signature _____

PAGE 1 OF APPLICATION AND TRUST RECEIPT.

MARKS, NUMBERS AND
DESCRIPTION OF COLLATERAL PLEDGED

ACT No. 9 OF 1914, LAWS OF LOUISIANA

AN ACT

Making it a felony to withdraw collateral pledged to a bank on a trust, or other form of receipt, and when so withdrawn to use, sell, repledge or otherwise dispose of same for any other purpose than that of paying the indebtedness; or to fail or refuse to return collateral so withdrawn on a trust, or other form of receipt, on demand, or in lieu thereof, to make to the pledgee a cash payment equivalent to the full value of said collateral; or should said collateral exceed in value the indebtedness it secures, to fail or refuse to make a cash payment to the pledgee equal to the full amount of said indebtedness; making the proof of certain facts prima facie evidence of criminal intent, but giving the State the right to prove intent in addition thereto by any competent evidence; dispensing the State from the necessity of proving that a person when acting in a representative capacity so withdrawing said collateral and using same unlawfully, derived any personal benefit or profit from said transaction; providing penalties for the violation thereof and repealing all laws or parts of laws contrary to or inconsistent herewith; provided, however, that nothing in this act shall be taken or intended to affect any prosecution which was pending in any court at the date of the passage of this act.

Section 1. Be it enacted by the General Assembly of the State of Louisiana, That any person that is a customer, or any person being an officer, member, agent, or employee of any person, partnership, or corporation that is a customer of any bank or banking institution, savings bank, or trust company, organized under the laws of this State, of the United States, or of any foreign country, or of a private banker, or of a person, firm or corporation that loans money on collateral security, doing business in this State, who is allowed to withdraw any collateral pledged by him, personally or in his representative capacity, on a trust or other form of receipt and, first, who uses, sells, repledges or otherwise disposes of said collateral so withdrawn, for any other purpose than that of paying the indebtedness for the security of which the said collateral was pledged; or, second, who fails or refuses to return said collateral on demand, or who fails or refuses in lieu of the return of said collateral to make to the pledgee a cash payment equivalent to the full value of said collateral so withdrawn, or should said collateral exceed in value the indebtedness it secures, who fails or refuses to make a cash payment to said pledgee equal to the full amount of said indebtedness, shall be guilty of a felony.

Section 2. Be it further enacted, etc., That proof of any of the acts set forth in section one of this act shall be considered prima facie evidence of criminal intent; provided, however, that the State shall have the right to proceed further, if it so elects, and prove such criminal intent by any competent evidence in its possession.

Section 3. Be it further enacted, etc., That in all cases, where the person doing the things denounced by this act, was an officer, member, agent or employee of any person, partnership or corporation that was the customer of the bank or person, firm or corporation loaning money on collateral security, it shall not be necessary, to complete the proof of crime charged, for the State to prove that such person derived any personal benefit, advantage or profit from such transaction; provided, however, the State shall always have the right to make such proof by any competent evidence it may have in its possession.

Section 4. Be it further enacted, etc., That any person violating any of the provisions of this law shall be deemed guilty of felony, and, on conviction, shall be imprisoned with or without hard labor for not more than ten years in the discretion of the court.

Section 5. Be it further enacted, etc., That all laws or parts of laws contrary to, or inconsistent herewith, are hereby repealed; provided, however, that nothing herein shall be taken or intended to affect any prosecution which was pending in any court at the date of the passage of this act under the provisions of Act 120 of 1910.

Approved June 11, 1914.

PAGE 2 OF APPLICATION AND TRUST RECEIPT.

International Acceptance Bank

INCORPORATED

Established April, 1921

31 Pine Street, New York

Statement of Condition as of September 15, 1922

RESOURCES		LIABILITIES	
Stockholders' Uncalled Liability . . .	<u>\$5,000,000.00</u>	Subscribed Capital and Surplus . . .	<u>\$15,250,000.00</u>
Cash on Hand and due from Banks . . .	\$ 4,323,131.72	Capital Paid In . . .	\$10,250,000.00
Acceptances of Other Banks . . .	1,964,396.54	Undivided Profits . . .	791,714.10
U. S. Government Securities . . .	10,711,562.30	Due to Banks and Customers . . .	11,358,063.79
Loans and Discounts . . .	3,913,881.47	Acceptances Outstanding (less held in portfolio) . . .	\$65,666.92
Other Bonds, Securities, etc. . .	3,597,605.19	Letters of Credit . . .	5,569,696.21
Customers' Liability, Acceptances (less Anticipations) \$2,014,431.03 . . .	22,110,470.18	Reserves . . .	76,573.07
Customers' Liability under Letters of Credit . . .	<u>5,569,696.21</u>	Total . . .	<u>\$52,190,743.61</u>
Total . . .	<u>\$52,190,743.61</u>		
INTERNATIONAL FINANCING COMMERCIAL CREDITS		FOREIGN EXCHANGE	
		FOREIGN SECURITIES BULLION	
DIRECTORS			
PAUL M. WARBURG, Chairman of the Board			
DANIEL G. WING, Vice-Chairman Pres. First National Bank of Boston	F. H. GOFF Pres. Cleveland Trust Co., Cleveland	WILLIAM SKINNER William Skinner & Sons, New York	
F. ABBOT GOODHUE President	ROBERT F. HERRICK Herrick, Smith, Donald & Parley, Boston	H. C. SONNE Ruth & Co., New York	
NEWCOMB CARLTON Pres. W. U. Telegraph Co., N. Y.	J. R. MCALLISTER Pres. Franklin National Bank, Phila.	PHILIP STOCKTON Pres. Old Colony Trust Co., Boston	
EMORY W. CLARK Pres. First National Bank in Detroit	CHARLES B. SEGER Pres. U. S. Rubber Co., New York	FELIX M. WARBURG Kuhn, Loeb & Co., New York	
WALTER E. FREW Pres. City Bank, New York	LAWRENCE H. SHEARMAN W. E. Grace & Co., New York	THOS. H. WEST, JR. Pres. R. I. Hosp. Tr. Co., Providence	

Foreign Credit Information.

From the Federal Reserve Bulletin, vol. 8, pp. 795-801 (July, 1922).

Introduction.

The methods of handling domestic credit information in the United States have been carefully studied for many years and are now well systematized. Trade organizations, as well as individual mercantile houses and banks, have devoted much time and effort to this question, on which the entire credit system rests, and to make the methods employed as efficient as possible. The extension of credit in the last analysis of course depends entirely on the credit risk. Exact knowledge of the buyer's status is needed. Many channels and sources have been developed with respect to domestic buyers, which are now available to the entire business community.

While the domestic field has thus been carefully developed, little interest has been manifested in information on foreign buyers. Only after 1914, when the foreign trade of the United States increased by leaps and bounds, did business houses and banks begin to pay more

attention to foreign credit information. In this respect American practice is somewhat the opposite of British and German practice, where the domestic credit work has not attained the same efficiency as in the United States, but where methods and sources for foreign credit information have been studied for many decades.

This is the first of a series of articles which will survey the various sources of credit information available on foreign names. The methods employed, both by American and foreign institutions, will be analyzed in turn. The first two articles will survey the foreign credit work of American business houses, and the methods used by the interchange bureaus, agencies and banks. Subsequent articles will consider practices in Great Britain, and leading continental European countries.

I. Foreign Credit Work of American Business Houses.

Credit policy.—It is generally believed that American exporters do not extend credit to foreign buyers as liberally as European competitors do, especially British and German. Whether this is true or not has yet to be ascertained. Answers to the questionnaire used by the Federal Reserve Board in this study throw some light on this point, and seem to indicate that the majority of American firms engaged in foreign trade are inclined to sell more and more on liberal credit terms, and wherever conditions are favorable encourage such transactions. Commission houses as well as manufacturers who have studied this field have come to the conclusion that business with foreign countries can be done only on a credit basis, if it is to be done at all.

The credit policy of individual houses naturally varies. Some extend credit only for 30 days, while others are willing to draw drafts running for 120 days. This latter figure seems to be the maximum term usually granted by American export houses. Firms at times sell on open account or grant four or six months, but such cases are rare. As a rule, however, it may be stated that American exporters are not in favor of selling on an open-account basis. Due largely to the handicap of lack of information on foreign buyers, and the unsettled conditions in many countries, terms granted by most American houses are not as liberal as those of their European competitors.

The credit policy used depends upon many factors. By far the most important are the financial and political situation of the country, and the reputation of the foreign firm. The attitude of export houses can be seen from the following two representative answers:

We endeavor to encourage sales on a time or sight draft payment basis. We do not encourage foreign business on an open account basis, although we sometimes sell on open account more through necessity than by choice.

There are no definite standard terms in foreign countries, and our attitude is based on (1) the stability and financial solidity of the foreign government, (2) the reputation of our customer in the said country.

Organization of credit department.—Almost every firm actively engaged in foreign trade operates a credit department of its own, whose duty it is to gather information and to pass on the credit standing of foreign buyers. The foreign credit department may be either independent or combined with the domestic credit work. Which method is better is difficult to say and depends to a large extent upon the special needs of the firm. Manufacturers doing both a domestic and foreign business usually combine their credit work, while houses conducting a general export business naturally have a separate foreign credit department. The organization of the foreign credit department varies with the firms in question. Exporters having branches or representatives abroad depend mainly upon the reports they receive directly and do not pay particular attention to developing their own files through other sources. One firm, operating a large number of branch offices in many countries, writes:

We depend largely on our foreign offices and agents for the maintenance of proper credit information and maintain files of information at this end merely for the purpose of occasionally checking up the operations of our representatives. All orders executed by us are solicited by and received through our own agents, who are expected to satisfy themselves in regard to the credit standing of the buyer.

Firms which have no such facilities are compelled to collect up-to-date credit information from any other sources which may be available.

The names of foreign buyers listed in the files of American exporters are divided into several groups. Some houses carry information covering only steady customers, or those with whom they have occasional dealings. Large exporters, however, have information on prospective and potential buyers too. A few go even further and assemble information on the credit standing of foreign banks. One export house, discussing the question of names carried in its files, writes:

We cannot draw strict lines between steady customers, occasional buyers, or prospective buyers. We usually look to our own travelers whom we send from our main office.

Another states:

We start an investigation immediately upon the opening of negotiations with a prospective buyer regardless of terms, which may be agreed upon for the first transaction because it may soon develop into an account where credit terms will have to be considered.

Investigation on a foreign buyer may be conducted either (a) when an order is received from a new customer or when he makes an inquiry,

or (*b*) when the exporter makes an offer or a quotation to a foreign merchant. The general tendency of American export houses is to commence an investigation as soon as an inquiry is received or an offer is made.

The most difficult task of the credit man is to keep his files up to date. In order to facilitate this work, files usually are divided into active and inactive accounts. The former are revised quarterly, half-yearly, or at least once a year. Revision of the latter is undertaken only on special occasions. The consensus of opinion is well summarized in the following answer:

We revise our credit files periodically, based on the activity of the account, the importance of the market, and the facilities for obtaining revised information.

II. Sources of Information.

The information contained in the files of the credit department may be secured from various sources. It may be collected directly from the purchaser, or the credit manager may ask a bank, commercial agency, or another institution to gather the necessary data for him. Where credit information is secured directly by the seller from the buyer, the best source in domestic trade is the financial statement. This, however, is very seldom given in foreign trade. Foreign buyers, especially in Latin America and the Far East, sometimes regard such a request as a personal insult and as reason to sever further business relations. The unanimous opinion of all the exporters approached is seen in the following replies:

It is not customary to ask foreign customers for financial statements; we think they would be offended, nor would we ever suggest that a foreign customer should answer any questionnaire that we may submit; it would be entirely unpractical for us to attempt it.

We do not require foreign buyers to furnish financial statements, especially not in Latin America, where a request of that nature would be viewed indifferently from the interpretation placed upon it in this country and might readily lose us a valuable customer. We do not believe that such statements are furnished except in rare instances.

We have occasionally received financial statements from foreign buyers, but this is only an occasional happening, and as a rule we do not receive them.

Accordingly, other channels have been developed which if properly handled work out very satisfactorily. The lack of a statement is naturally less felt by houses which have agencies or representatives abroad. In most cases these representatives receive their information through other channels than inquiries made direct to buyers. Agents, representatives, or traveling salesmen are often in a position to gather reliable

information from their daily contact with the market, and are at times able to judge the credit standing of a foreign customer from their past experience. In rare cases, however, where such information is not available, and where a larger transaction is involved, they may request an inspection of the books.

Firms which have no representatives abroad usually ask a prospective buyer for bank or trade references. These may be American banks and business houses, or foreign banks and merchants with whom the buyer has business relations. The value of these references depends to a large extent upon the individual given as a reference, and therefore the opinion expressed by manufacturers and exporters differs greatly. Some believe that the best and most reliable information is given by foreign institutions, even though it is very often briefly expressed. Others state that the only reliable information is given by Americans, and that they never ask a foreign firm for any information. It is often stated that information received from American banks, although in most cases fully detailed, is not always up to date. Almost all exporters, however, agree that credit data obtained through an interchange bureau are particularly valuable. The ledger experience of other American merchants who are dealing with foreign buyers is considered as the best source of information through which a seller may determine what action he should take relative to the length of terms and methods of payment.

The information asked for by exporters includes the reputation of the foreign buyer in his local market, the character of the management, and the manner in which the business is conducted. These items if received from reliable sources are thought to be more valuable and indicative than the "cold figures of a financial statement."

Some firms at times ask their prospective buyers, but more often their agents and representatives abroad, to fill out a blank along the following lines:

The home office is to be supplied with as full and complete information as possible on the standing of the following firm:

1. Customer's name and full address.
2. Their standing individually and as a firm or corporation.
3. How long established.
4. Report from the bank with whom they do business.
5. Their estimated or stated financial worth in and out of business.
6. From whom they purchase in the United States of America.
7. Other references.
8. Copies of financial statements if same are made and issued.
9. Full details as to the nature of their business.
10. Give as full a report as possible of financial conditions throughout your territory with clippings from local newspapers in financial matters. Report

fully on all matters which would tend to affect exchange rate between the United States of America and countries in your territory.

It will facilitate our work at the home office if, on sending in reports on customers, each is given a separate sheet.

Exporters are not always able to get satisfactory credit information directly from their foreign customers. This compels them to apply often to what may be called "indirect sources." Such channels are consulted even where direct credit information has been obtained, in order to check and to supplement the gathered information. The most important and most consulted indirect sources of information are domestic and foreign banks. The methods and practices employed by these institutions in collecting material will be discussed in subsequent articles. Consideration at this point is therefore given only to the question of how far exporters use these sources, and to what extent they rely on information given by banking institutions.

An exporter may request credit information on a foreigner from his own bank, an American overseas bank, the foreign branch of a domestic bank, or a foreign banking institution. As a matter of practice, however, exporters and manufacturers apply mainly to their own banks. In cases where the services of foreign institutions or American overseas banks are needed, merchants ask their own banks to inquire of the above-named institutions.

The credit information given by banks is of utmost importance to houses who have no agencies and representatives abroad, and who rely almost entirely upon the banks. Objection is often made that overseas banks and foreign branches of American banks are reluctant to give credit information directly and when done their reports are very brief and do not contain detailed information. It is, however, the general belief that credit data given by American banks are by far more reliable and valuable than information furnished by foreign banks. The latter are also unwilling to give information direct to American business houses. The following answers from two large firms engaged in foreign trade express the general opinion of American business houses with regard to information given by banking institutions:

We consider the most reliable information received is that secured from American overseas banks or foreign branches of American banks.

- We think the best information is obtained from banks in this country who have foreign branches or who are in a position to secure information from other banks.

The credit information made available by American banking institutions, trade organizations, and individual houses increased considerably in the last few years, but many problems still remain. In their replies

exporters, manufacturers, and trade organizations indicate many difficulties which they encounter. The secretary of an important association fostering foreign trade writes:

I consider the lack of credit information one of the greatest drawbacks to foreign trade. Individual banks are interested in special countries. Credit bureaus have not the money properly to develop the business.

Other deficiencies especially pointed out by many merchants can be seen from the following answers:

The major lack is failure on the part of many exporters to co-operate with organizations established for the gathering and dissemination of credit experience. If all manufacturers and exporters were combined in the organization already established for that purpose, the individual position would be strengthened and the danger of incurring unsafe risks would be minimized or eliminated entirely.

Not enough information is available with regard to payment of drafts.

Information given on foreign buyers is in most cases too old to be of any value.

Lack of detailed and reliable information is the main defect of the present status of credit information.

Lack of information as to how much credit has already been given to foreign customers by other exporters in this country.

Duplication of information furnished by various sources based on correspondents having the same foreign bank sources of information.

Many exporters report that a great mass of valuable credit information is accumulated in the files of American houses, but these data are in most cases scattered and very difficult and expensive to obtain. To remedy this situation many suggestions have been made. Some of them have already been incorporated in the services offered by banks and trade organizations. Others, such as the suggestion made by one firm that a central credit interchange bureau be created, deserve close attention. In any event, however, co-operation among all interested in the extension of foreign credits is necessary. This would enable the credit standing of foreigners to be analyzed in a more satisfactory manner, and prevent many losses now incurred by bankers and merchants.

III. Trade Organizations.

Several institutions have developed departments to obtain foreign credit information either through interchange of ledger experience by American exporters or through reports from their own representatives or correspondents abroad.

1. **Foreign Credit Interchange Bureau of the National Association of Credit Men.**—This institution is a mutual co-operative organization consisting of manufacturers, merchants, and export commission

houses, and aims to serve as a clearing house for the ledger experience of its members. It is a comparatively new organization, established in 1919, at a time when American business men interested in foreign trade felt most keenly the lack of accurate foreign credit information. Its operating mechanism and functions are described by the bureau as follows:

As each member is accepted by the bureau a number known only to the member and the manager of the bureau is assigned. Forms for supplying the bureau with a list of the member's customers in foreign countries and export commission houses in this country are provided. Nothing appears on this list of customers except the number assigned to the member.

When the list is received by the manager, he consults the card index files of the bureau to ascertain if the name is already listed. If it is listed, the number assigned the member is then placed upon the card bearing the name and address of his customer. When a name not listed appears on the list, a new card is made out, and the member's number is placed on the new card. This method serves a dual purpose, viz., it enables the bureau to know where to secure information and in case of receipt of interesting information regarding an account makes possible a guarded dissemination to only those interested.

When an inquiry is received, it is immediately looked up in the files. If a recent report is on hand, a copy is sent to the inquiring subscriber by return mail. If nothing is available from the files, an inquiry is sent to each subscriber that has had experience with the particular firm under investigation.

The information gathered by the bureau from its members may be divided into three main groups: (1) Terms of sale, (2) amount outstanding, and (3) manner of payment. Whenever a member makes an inquiry concerning a foreign buyer, the following form is sent by the bureau to all members whose number appears on the index card of the firm in question, and which indicates that they have business relations with it.

Date No.

FOREIGN CREDIT INTERCHANGE BUREAU.

Will you kindly furnish this bureau your ledger experience, if any, with the following:

Please use this form in making reply; in consideration of your courtesy in so doing we will be glad to send you a copy of the completed report gratis:

Name.....
 Business.....
 Street..... City.....
 Country.....

KEY.

TERMS OF SALE.

- i. Open account payable days from date of —
 - (a) Invoice.
 - (b) Factory shipment.
 - (c) Export shipment.

2. Open account payable immediately upon receipt of —
 - (a) Documents.
 - (b) Invoices.
 - (c) Goods.
3. Account guaranteed. How?
4. Voluntary remittance with order.
5. Sell for cash in advance only.
6. C. O. D. or S/D to R. R. B/L.
7. Cash against documents under confirmed L/C.
8. Cash against documents under unconfirmed L/C.
9. Bank acceptance of bank in this country at days.
10. Bank acceptance of foreign bank at days.
11. Draft at days sight through banks for collection d/a.
12. Draft at days date through bank for collection d/a.
13. Draft at days sight through bank for collection d/p.
14. Draft at days through bank for collection d/p.
15. Draft at days sight through bank for collection documents to customer.
16. Draft at days date through bank for collection documents to customer.
17. Consigned stock.
18. Cash against shipping documents, dock receipt or warehouse receipt:
 - (a) At customer's office.
 - (b) At paying agency other than bank.
19.

MANNER OF PAYMENT.

Open account.

- A. Discounts.
- B. Pays when due.
- C. Slow.

Drafts.

- H. Anticipates payment.
- I. Accepts and pays promptly.
- J. Accepts promptly—delays payment.
- K. Delays acceptance—pays promptly.
- L. Delays both acceptance and payment.
- M. Makes unjust claims.

General.

- N. Account settled by attorney.
- O. Account settled by arbitration or compromise.
- P. Account still in dispute. We rate the account —
- Q. High.
- R. Good.
- S. Satisfactory.
- T. Unsatisfactory.
- U. Undesirable.

How long sold	Terms of sale		Highest recent account	Date last dealings	Amount now owing including outstanding drafts	Amount past due	Number of days past due	Manner of payment	Rating	Credit limited (if any)	Credit declined (give reasons)	Remarks
	Key	Details							(Use code.)			
	No.											

General comment

.....

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.....

.....

To.....

.....

As soon as the answers are returned they are classified and listed on a standard sheet. A complete report is then sent to the original inquirer and to all those members who have contributed to the report. One copy is kept on file in the offices of the bureau. The final report reads as follows:

FOREIGN CREDIT INTERCHANGE BUREAU

Report on:
Estaban E y Cia,
Ave. Florida 47,
Mexico City, Mexico.

Nov. 31, 1921.

Sheet 811—S

Inquiry, 11150

How long sold	Terms of sale		Highest recent account	Date last dealings	Amount now owing, (includ- ing out- standing drafts)	Amount past due	Number of days past due	Manner of pay- ment (Use code.)	Rating (if any)	Credit limited (if any)	Credit declined (give reasons)	Remarks
	Key No.	Details										
<i>Years</i>		<i>Days</i>										
8	I	90b	10000	6-21				A	Q			2%—10 days. Note "A." Note "B." 4%—10 days.
10	I	120b	5000	4-21				B	Q			
2	I	60a	2000	5-21				Prompt	S			
6	II	60	1500	9-21	1500	1500	5	H	S			
I	I	30a	1105	4-21				A	Q			

Note "A": One of our best Mexican accounts. Know members personally; are thoroughly experienced, conservative, and of good reputation.

Note "B": Always very prompt. Anticipate payment any day now.

Explanatory—The above report includes the experiences of five subscribers. Each line as read from left to right indicates the experience of one subscriber.

The advantages of the type of information collected and given by the credit interchange bureau are self-evident and require no further discussion. The service, however, is limited to those firms which already had business relations with American houses. The more firms which participate, the wider becomes the basis of interchange and the more valuable the information. At a recent meeting between representatives of some large banks and officers of the bureau, the banks decided to join the institution. This will enlarge the activities of the bureau and render its services more efficient.

2. **The National Association of Manufacturers.**—To facilitate international commerce this organization has opened a foreign-trade department, which, in addition to other services offered, is able to gather information on the credit standing of foreign buyers. The association has about 3,000 correspondents abroad, mainly lawyers, merchants, and bankers, who for considerations ranging from \$1 to \$5 give information on merchants in their districts. Each report is filed in the offices of the organization, which at present has accumulated data on more than 35,000 foreign merchants.

The information is based upon answers of one or more correspondents. In most cases the association endeavors to receive data from diverse sources so as to be able to give more accurate information. To make the data standardized, forms in English, French, Spanish, and German are sent to the foreign correspondents. A form forwarded to foreign buyers reads as follows:

THE NATIONAL ASSOCIATION OF MANUFACTURERS

NEW YORK, U. S. A.

Special correspondents in all countries and every town of commercial importance.

Business houses receiving this form are respectfully requested to return it with replies to the questions they care to answer. They are assured that all particulars given will be discreetly used. The information is asked simply for the purpose of promoting international commercial intercourse.

The National Association of Manufacturers is always glad to afford information with respect to American products and to place inquirers in direct communication with the makers of any class of goods, but cannot undertake to do this without knowing something about its correspondents.

Those who have already filled out and returned forms of this kind are requested to note any changes which may since have taken place and add any other information they would like to have filed:

1. Name
2. City State Country
3. Street address
4. Name and nationality of partners
5. Are you merchant carrying stock for your own account?
6. Do you sell at wholesale or retail?

7. Do you act as manufacturers' agents?.....
8. Do you manufacture any goods.....; if so, what line?.....
9. Principal lines of goods handled.....
10. When established.....
11. Amount of own capital.....
12. Average value of stock carried.....
13. On what terms do you usually buy?.....
14. Through what commission house (if any) do you import?.....
15. Bank or other references.....
16. From what houses in the United States have you purchased goods?.....
-
17. If you are an agent please state what business experience you have had,
what firms you represent, the territory you cover, and the year you
were born. (An agent's photograph is always appreciated and filed.)
.....
-
18. Cable address.....Codes used.....
Date.....Signature.....

This form, it will be observed, is somewhat similar to that employed by certain exporters, and reproduced above.

In addition, the offices of the association are equipped with a great number of trade reports and trade directories for practically every country in the world.

3. **The Philadelphia Commercial Museum.**—It is one of the oldest organizations in the country which furnishes foreign credit information. The credit data are obtained from correspondents abroad, from banks and other sources. As soon as information is received, it is compiled on a standard sheet and mailed to the original inquirer.

4. **Other trade organizations.**—Among other organizations endeavoring to furnish their members with foreign credit information, the best known are the American Manufacturers' Export Association, and the American Exporters' and Importers' Association. The information of the latter is more in the nature of credit clearing or credit interchange, and is said to be very effective and valuable to its members. The former association has done little to develop any sources of its own and depends largely upon credit data given by New York and out-of-town banks. The information thus received is more limited in scope.

IV. Mercantile Agencies.

To meet the growing need for credit information desired by American business institutions, several mercantile agencies have been established. Some of them devote their activities entirely to the collection of credit information on foreigners, while others report on domestic as well as foreign names. To the latter group belong the two widely known commercial agencies, R. G. Dun & Co., and Bradstreet's.

The R. G. Dun company operates a large number of branch offices and reporting agencies all over the world. It has agencies and branches in England, France, Belgium, Holland, Switzerland, Spain, and in practically all important places in Canada, Australia, Central and South America. In addition to their branches and agencies, the company maintains several thousand individual correspondents who report either directly to the foreign department of the home office in New York, or to the head offices in their respective districts. The New York office states that it has information on several hundred thousand foreign names.

The organization of Bradstreet's is somewhat similar in nature. The information on foreigners is gathered through the medium of 84 offices outside the United States which are operated either by The Bradstreet Company, Bradstreet's British (Ltd.), Bradstreet's International (Ltd.), Bradstreet's Belge, S. A., or in conjunction with allied organizations. In some instances the agency has reached a working arrangement with other agencies abroad.

Among special agencies may be mentioned the National Credit Office. It was originally established to report credit information to the textile trade. Since 1919, however, it reports also on foreign customers of its subscribers.

The Authority to Purchase.¹

From the Federal Reserve Bulletin, vol. 7, pp. 926-931 (Aug., 1921).

I. Introduction.

Previous studies, conducted by the Division of Analysis and Research in methods of financing foreign trade, have dealt mainly with the letter of credit. The results of these surveys have appeared in the current issues of the *Federal Reserve Bulletin* for February, April, and June, and have presented such phases of the letter of credit as its legal aspects, forms used, and practices followed by American banks and mercantile houses. The following study examines the "authority to purchase," an instrument which serves a purpose in foreign trade quite similar to that of the letter of credit. In fact, these two documents are the means of shifting the burden of financing an overseas transaction from exporter to importer. These instruments are therefore of special significance to American foreign trade, which to-day consists more largely of exports than of imports. The letter of credit is of major importance since it is applied in financing trade with all the world, while the authority to purchase has less significance, for its use is confined mainly to commerce with the Orient. In this field, however, it plays a commanding

¹ Prepared under the direction of George W. Edwards, Division of Analysis and Research.

rôle, for exports to the Far East are financed mainly by the authority to purchase. Because of its specialized use, this instrument has received scant attention from writers dealing with foreign trade, and works on far eastern banking have given it slight consideration. The preceding studies of this series developed some expressions of opinion from American bankers and traders on the nature of the authority to purchase, but these responses indicated that it was little known in the United States outside of New York and San Francisco. It was therefore thought advisable to conduct a more intensive analysis of the document, especially because of its significance in oriental commerce, which has always been a center of interest to trading nations.

The data presented in the following study were gathered from banks in New York City mainly through personal interview, and from outside institutions largely through a questionnaire circulated by the Federal Reserve agents. While the earlier surveys have been confined to American institutions, it was necessary to extend this analysis to the New York agencies of foreign banks, which gave helpful co-operation in securing information on the subject.

While the data regarding the authority was thus gathered largely through answers to a questionnaire as in previous studies, the results will be presented not in the form of tabulations and excerpts from these responses, but rather as a general exposition of the salient characteristics of the instrument. This change in treatment is due to the difference in the purpose of the studies, for in analyzing the letter of credit, the aim was to present views on problems more or less unsettled, while in examining the authority to purchase the object is to set forth information on a subject whose principles are not generally known to American business and banking interests. This survey will explain the nature, classes, forms, and practices of the authority, and finally compare it with the letter of credit.

II. Meaning.

A shipment in foreign trade may be financed either by the exporter, the importer, or their respective banks. If the obligation of supplying the credit is to be carried by the exporter, he draws his drafts on the importer and forwards them through his bank for collection. The exporter may transfer the burden of furnishing the credit by selling the drafts to his bank. A third method may also be followed whereby the task of supplying the credit is shared by both the exporter and his banker. This occurs when the latter does not purchase the draft outright, but instead advances a certain percentage of the face amount to the exporter.

The financing of an overseas transaction by the importer rather than the exporter is performed either through a letter of credit or an authority to purchase. In the Far East, where banking facilities have until recent years been limited, it has often been impossible for an importer to secure bank credit for the financing of his business. To meet this need the authority to purchase or, as known in its abbreviated form, the A/P, was developed. Its operation may be illustrated by describing the financing of a shipment of goods from an American exporter to a Chinese importer. As the transaction is not to be financed through a letter of credit, the exporter cannot draw his drafts on a bank, but must address them to the importer himself. It may, however, prove difficult to find a bank which cares to purchase such trade bills, and hence the exporter normally has no other choice but to forward his drafts for collection. This applies especially to a shipper whose credit is so limited or overburdened that he is unable to secure accommodation from a bank in financing his transactions. To create a market for the shipper's drafts, the importer is then called upon to finance the transaction by an authority. This he does first by informing a bank in his own country that he has authorized the exporter to draw his drafts, and then requesting the bank to arrange for the negotiation of these bills by a branch or a correspondent located near the exporter.

The importer, of course, assures his bank that he will provide funds for the retirement of these drafts at maturity, also that he will reimburse the bank for its services and protect its interests with sufficient collateral. This document which the importer thus addresses to his bank is frequently confused with the authority to purchase. It is, however, a separate instrument and may better be termed a "letter of guaranty." It is quite similar to the combined form of application and guarantee sometimes used in requesting a bank to issue a letter of credit. If the far eastern bank acts favorably on the application of the importer it will then address to its American branch or its correspondent a communication instructing the latter to negotiate the drafts drawn by the shipper in the United States on the importer in the Orient. It is the practice immediately to cable this information, and later to send a letter with complete details. This letter constitutes the true authority, also known as the "authority to negotiate" or the "advice to purchase." It is entirely distinct from the "authority to draw" sent to the exporter. It is also different from the "advice of authority to purchase" forwarded by the correspondent bank to the exporter for the purpose of informing him that he has been authorized to draw drafts on the importer, and that the bank has been instructed to negotiate his bills on the presenta-

tion of proper shipping documents. This "advice of authority to purchase" may of course be sent directly to the exporter by the bank in the Orient, but it is more customary to forward the communication indirectly through an agent, whether a branch or a correspondent, located in the exporter's city. As the "advice of authority to purchase" is thus a communication from a bank to a beneficiary, it performs the same function as a letter of credit and so is frequently styled a "Chinese" or "Oriental" letter of credit. Therefore in financing a shipment under the so-called "authority to purchase" method, four separate documents are actually involved. The first is the communication by importer to exporter in which the latter is advised of the terms of sale and the right to draw drafts on the former. This document is known as an "authority to draw," but it is of no direct interest to the banks, for it is merely part of the commercial contract between buyer and seller. Banks, however, are more concerned in the remaining documents, namely, the letter of guaranty addressed by the importer to the far-eastern bank, the authority to purchase forwarded by the far-eastern bank to its American agent, the advice of authority to purchase sent by the American agent to the beneficiary.

III. Classification.

Authorities, the same as letters of credit, may be classified along such principles as: (1) direction of shipment, (2) tenor of drafts, (3) form of currency, (4) privilege of cancellation, and (5) right of recourse. Although the instrument may be used to finance either an export from or import to the United States, in actual practice the authority is largely applied to the movement of exports, and, in fact, most banks report that all the authorities which they handle cover only export transactions. Therefore, while American banks perform the duties of notifiers of authorities and payers of drafts, they rarely, if ever, act as issuers. While drafts instructed under an authority may be drawn either at sight or on time, the latter tenor is generally used. Banks report that about 85 per cent of these drafts are drawn on a time basis which may run for 60, 90, or 120 days' sight. Moreover, these drafts are payable not in Oriental currency but in United States money, and the exporter usually receives the full amount of the bills. In short, drafts made under authorities are ordinarily based on export transactions drawn on a time basis and payable in United States currency.

It is, however, more difficult to classify the authorities from the standpoint of the right of cancellation. It will be recalled from the previous studies of letters of credit that these instruments, grouped on the principle of whether they could be revoked, are classified as follows:

- (1) Irrevocable by issuer and confirmed by notifier.
- (2) Irrevocable by issuer and unconfirmed by notifier.
- (3) Revocable by issuer and unconfirmed by notifier.

The same classification may also be applied, with certain modifications, to the authority. As mentioned above, the authority is not ordinarily sent by the issuing bank directly to the beneficiary, but is more usually transmitted to him through a second notifying bank, and therefore the subject of confirmation is of some theoretical importance. However, this question loses some of its importance, for an authority is generally opened by a domestic agency of the foreign bank which has originally issued it. An authority may be irrevocable by the issuing bank and further confirmed by the notifying institution, in which case it becomes practically a letter of credit, for it constitutes the direct obligation of both issuing and notifying banks to negotiate the bills and can be rescinded only with the consent of the beneficiary. The form of authority transmitted by the notifying bank to the beneficiary contains an address which unequivocally informs him that the bank has been authorized to pay his drafts and that his right to draw these bills continues until a fixed date of expiration. The notifying bank is not always requested to confirm the authority, and in this event it is unconfirmed as far as the notifier is concerned but still irrevocable by the issuer. In this contingency the advice which the notifier communicates to the beneficiary may assume the following form:

We beg to advise that we are to-day in receipt of instructions from our correspondent, the _____ Bank, authorizing us on behalf of _____ to negotiate your _____ documentary drafts.

At the same time this advice specifies the expiration date for the authority, but is careful to add a statement that it is subject to cancellation. The form used by one bank states definitely its relation to the entire transaction in this manner:

We have no instructions to confirm this advice and make no representation that we have funds in our possession applicable to the payment of said drafts and reserve the right to cancel this notice or refuse to negotiate any drafts presented in accordance herewith at any time.

The third form of the authority is that type which is revocable by the issuing and unconfirmed by the notifying bank. This document is quite similar in wording to the advice of an irrevocable unconfirmed authority. The bank naturally holds that the unconfirmed authority may be revoked at any time prior to the payment of drafts drawn by the beneficiary. This view is usually expressed in the advice to the recipient in a statement that the authority may be canceled upon notice to this effect. Nevertheless, this is a right which a bank should exercise with

utmost care, especially in dealing with an exporter manufacturing or preparing goods not staple in character and therefore limited in marketability.

It appears that, before the war, authorities were generally revocable in form, but during the past seven years sellers of goods have been in a position to demand irrevocable obligations. This was a natural result of the period of rising prices and the sellers' control over market conditions, but in the present movement of falling prices, with the consequent return to power of the buyers, it appears that eastern importers are insisting that American exporters accept revocable rather than irrevocable authorities.

In turning the discussion from the subject of cancellations to that of recourse, it must be borne in mind that a relation does not necessarily exist between these two principles. The question of cancellation affects the authority before negotiation of the authorized drafts, while the subject of recourse enters into consideration only after the purchase of these bills. At this point it may be mentioned that the Law of Negotiable Instruments permits the drawer of a draft to add after his signature the expression "without recourse" and in consequence of this act he is relieved of the usual liabilities of a drawer in the event that his bill is dishonored by the drawee. The subject of recourse under letters of credit has already been discussed in the *Federal Reserve Bulletin* for June, 1921, page 684. Although the letter of credit seldom contains any reference to recourse, by implication there is no practical recourse on the drawer of drafts under an irrevocable form. But it is customary to insert in the authority sent to the beneficiary a sentence which reads somewhat as follows:

Please note that this advice is *not* to be considered as being a bank credit and does not relieve you from the ordinary liability attaching to the drawer of the bill of exchange.

Even if this statement is omitted, it is usage among banks to regard drafts drawn under authorities as carrying full recourse to the drawers until the bills have been honored by the drawees. This implication naturally may be nullified by inserting in the notice to the beneficiary an expression which permits him to specify on his draft that it has been drawn without recourse to himself.

The question of recourse among the various parties to an authority will be more clearly understood by tracing a complete transaction financed under this method. In the first place, the exporter draws his draft on the importer and presents his bill together with his documents to the local bank which has notified him of the authority. This bank examines the documents, and if they are regular in form it gives him a

check for the face amount of the draft. As the paying bank is acting in behalf of its foreign branch or of a closely affiliated institution, it then debits the account of this far-eastern bank and forwards drafts and documents for acceptance. Upon receipt of these documents, the issuing bank presents them to the importer for his acceptance and at maturity for ultimate payment. If he meets these obligations the entire transaction is closed, but if he dishonors the drafts either at the time of their acceptance or payment, the question of recourse immediately arises. In the first place, if the far-eastern bank has issued the authority directly to the drawer, it reserves full recourse. However, it is more customary, as seen above, to transmit the authority to the beneficiary through an American notifying bank which takes the position that it is merely an agent of the foreign issuer and therefore has the right of action on the drawer. Lastly, as to the relations between negotiator and issuer, there is entire agreement among banks that the former has full recourse upon the latter until final payment. The negotiating bank further protects itself by usually stamping upon the drafts the declaration that it in no way holds itself responsible for the ultimate fate of the bills. The sole liability which the negotiating bank incurs is its obligation for the correctness of the shipping documents. The question of recourse between issuer and notifier in actual practice is really of small importance, because these two institutions usually stand in relation of home office to branch or agency.

Regarding relations between the right of recourse and the right of cancellation there appear to be two divergent views. One contention is that a revocable authority necessarily gives rise to the drawing of drafts with recourse, while an irrevocable instrument by implication permits the drawing of drafts without recourse. However, as observed above, it is the general opinion that there is no relation between these two subjects, and authorities theoretically may be issued in four types: (1) Revocable without recourse, (2) revocable with recourse, (3) irrevocable without recourse, (4) irrevocable with recourse. The first type is rarely found, while the second is widely used. The third form, which assures the beneficiary that his drafts will be negotiated until a certain time and that his bills may be drawn without recourse to himself, is practically a confirmed letter of credit and seldom appears under the name of authority. However, the fourth form is of little service to the recipient, for although this authority may not be canceled, still there is always recourse to him if his drafts are dishonored by the drawee.

In summary, most authorities are revocable in form and call for drafts carrying full recourse to drawers.

As explained above, the financing of a shipment under an authority involves the issuing of three separate bank instruments, the letter of guaranty to the issuing bank, the authority to purchase to the notifying agent, and the advice of authority to purchase to the beneficiary. These communications may be sent as ordinary letters, but it is customary for banks which handle many of these transactions to use set forms such as those presented below:

DEAR SIR: You are hereby instructed to negotiate drafts drawn by _____
on _____ at _____ days' sight to the extent of _____ against shipment of _____
to _____ within _____ months from this date.

Each draft must be accompanied by a full set of shipping documents, consisting of invoice, bills of lading filled up to order, and blank indorsed. Certificate of Origin { required } Insurance (marine and war) { not required } { policy to accompany the drafts } { in China }

This instruction not being a bank credit is revocable and does not release drawer from liability.

All drafts drawn under this A/P must be marked as drawn under A/P No. _____ dated _____ 19__.

Kindly advise the beneficiary of the above and oblige.

Yours faithfully,

For the X Bank,

.....
Manager.

3. ADVICE OF AUTHORITY TO PURCHASE.

_____, 19__

Exporter.

DEAR SIR: We beg to inform you that we have been authorized by _____ at _____ to negotiate your bills on _____ (importer) to the extent of _____ for _____ invoice cost of _____ shipped to _____.

The bills are to be drawn in duplicate at _____ sight and must be accompanied by full set of bills of lading, invoices, and marine insurance policies, all in duplicate.

Shipping documents must be made out to "order" and blank indorsed.

The above documents must be duly hypothecated to the bank against payment of the bills.

Please note that this advice is not to be considered as being a "bank credit" and does not relieve you from the ordinary liability attaching to the "drawer" of a bill of exchange.

All drafts under this authority to purchase to be marked: "Drawn under A/P No. _____" with interest added thereto at _____ per cent per annum, from date hereof to approximate due date of remittance in New York. Payable at the current drawing rate for the X Bank's drafts at sight on New York.

Kindly hand in this letter with your drafts in order that the amount of same may be indorsed on the back hereof.

This authority expires on _____, but is subject to cancellation by our giving you notice to such effect.

Yours faithfully,

.....
(Notifying bank.)

It will be observed that the first instrument consists of an application and a guaranty. In the application the importer stipulates the conditions under which the authority shall be issued. These terms describe the form of drafts and the kind of documents. The expiration date is usually determined by the period within which the drafts are to be drawn. In the guaranty, the applicant usually agrees to accept the drafts on their presentation, to pay the commission, to absolve the bank from all responsibility for the condition of documents or goods and to pledge the merchandise as collateral.

It is unnecessary at this point to enter into a detailed analysis of the forms of the authority to purchase and the authority to draw, for their general characteristics have been studied above, and besides, these instruments have features in common with the letter of credit as described in the *Federal Reserve Bulletin* for April, 1921 (pp. 410-415). It will therefore be sufficient to confine the examination of forms to those phases which are peculiar to authorities. The letter of credit usually specifies that bills of lading must be indorsed directly in favor of the bank negotiating the drafts, but the authority generally calls for the drawing of these documents to order and indorsed in blank. Although the bills of lading are thus in negotiable form, the paying bank's title to all the documents is fully recognized by having the shipper sign an hypothecation certificate.

As the drawer of the drafts receives payment for their full amount without the deduction of any discount, and as the paying bank immediately debits the account of the issuing bank, the latter is therefore entitled to interest from the date of payment. Provision is made for this charge by inserting on the bill the "far-eastern interest clause" which reads as follows:

Payable at the collecting bank's rate for sight drafts or with interest from date of draft until date of approximate return of proceeds of the draft.

The authorities as a rule provide space on the reverse side for entering details of drafts negotiated, but banks apparently do not insist upon these entries in case of "without recourse" authorities. In fact, the only purpose of such records is to prevent a beneficiary from negotiating his drafts several times at different banks and thus overdrawing the amount allowed him. However, this difficulty does not arise in the case of the authority, since the advising bank alone is designated as the paying agent, and therefore no other bank would be likely to negotiate the drafts. For the same reason it is also unnecessary for a bank to demand the return of an authority which has not been exhausted, since it cannot very well be misused after its expiration if irrevocable, or after cancellation if revocable.

V. Comparison Between the Authority and the Letter of Credit.

The above analysis has presented the meaning, classification, and forms of the authority and it now remains to compare this document with the letter of credit. The function of these instruments is the same because they both transfer the burden of financing the transaction from the exporter to the importer or his bank. Both documents enable the exporter to receive reimbursement for his goods on presentation of the proper

documents, and therefore both the authority and the credit letter are in a way d/p or documents on payment instruments. The underlying principle is the conferring upon the exporter of the right to draw drafts. In fact, the similarity between the two instruments has led a number of bankers and exporters to term an unconfirmed letter of credit an authority to purchase. In order to avoid confusion in terminology there is a tendency among banks engaged in oriental trade to issue only two instruments, an irrevocable letter of credit and a revocable authority. A further point in common may be noted in the documents ancillary to both the letter of credit and the authority. In financing a shipment under either of these two methods, it is necessary to employ a letter of guaranty from the importer to the issuing bank, a communication between issuing and notifying bank, and an advice from the notifying bank to the beneficiary.

The letter of credit and the authority, however, differ widely as to actual use, for in general the latter is far more specialized. As mentioned above, the letter of credit is used to finance trade to all countries and to cover import as well as export transactions. On the other hand, the authority is applied mainly to far-eastern commerce and is used almost exclusively to facilitate exports from the United States. Under letters of credit, drafts may be drawn either at sight or on time, in dollars or in sterling and other foreign currencies. However, bills executed by virtue of authorities are usually made on the acceptance basis, and because of the uncertain nature of most far-eastern currencies in the past, it has been the custom for exporters to insist upon payment in United States money. The letter of credit may be handled through any correspondents, but the authority is opened mainly with branch banks or other closely associated institutions. Comparing the two documents from the viewpoint of cancellation and of recourse, it was observed above that the letter of credit is usually irrevocable and allows the drawing of drafts practically without recourse to the beneficiary. However, the authority is usually revocable in form, and the issuing bank generally reserves the right of recourse to the drawer. Lastly, the fundamental distinction lies in the fact that the authority is not a bank credit. Banks at times erroneously describe their authorities as "credits," but the instrument in no sense is the undertaking of the issuing institution. While the letter of credit imposes the burden of financing the transaction upon the bank, the authority places this obligation upon the importer himself. In the first case, the accredittee is given the right to draw upon the bank, and this leads to the creation of bankers' bills.

On the other hand, the authority instructs the beneficiary to draw on

the importer, and as time bills are usually made, these in consequence become trade acceptances. Because of the superior credit standing of the drawees, bankers' acceptances under letters of credit may be freely sold in the open market. The holder of these bills is able to dispose of them in any money center which offers the lowest rate, and so the cost of financing the entire enterprise may be materially lowered. The owner of bills drawn under an authority does not possess this freedom of action, since the drafts are made not on a bank but on a merchant.

Therefore it is quite impossible to find a buyer outside of the bank advising the authority, and so these bills are carried by the far-eastern bank. Because of these limitations, the discount rate on such trade bills is far in excess of that carried on bankers' acceptances. While the rate on bankers' bills drawn under letters of credit is determined largely by market conditions and is more or less variable, the charge for trade bills made under authorities must necessarily be fixed in this document. This rate has recently run as high as 9 per cent, but since the 1st of July, 1921, the maximum has been reduced to 8 per cent.

Commercial Letters of Credit.¹

*From the Federal Reserve Bulletin, vol. 7, pp. 158, 162, 163
(February, 1921).*

Due to the general fall in prices of commodities, the question of the rights and liabilities of the various parties to commercial letters of credit has become a matter of vital interest. The following article contains preliminary results of a study undertaken to ascertain present conditions in the financing of foreign trade.

Introduction.

In the financing of an importation there are several possible combinations of parties at interest. Although a shipment is made direct by the exporter in a foreign country to the importer in the United States, the seller does not usually rely upon the unsupported credit of the buyer abroad and generally requires a bank guaranty. The importer, therefore, calls upon his bank to lend its credit to the transaction and thus the exporter is given the right to draw upon a banking institution instead of a commercial house. But even this added responsibility does not always satisfy the exporter, who may prefer funds in his own country, and, in this event, the American bank requests a correspondent foreign

¹ Prepared under the direction of G. W. Edwards, Division of Analysis and Research.

bank to notify the exporter that it will negotiate his drafts. He may, therefore, sell his bills of exchange either to the notifier or to his own local bank. Hence, a letter of credit may involve such different parties as the importer, credit issuer, notifier, negotiator, any indorser of the completed drafts, and lastly the exporter.

The legal relations between these parties are expressed in a number of documents, but in this discussion only the import and export letters of credit need be considered. The import letter of credit is the authorization addressed to the beneficiary in one country by the credit-issuing bank in another under which the former is given the right to draw drafts up to a specified sum and within a definite time, and the latter undertakes to honor the drafts when presented. The export letter of credit is the advice from a bank to the beneficiary that a credit has been opened in his favor by a foreign bank and that the notifying bank agrees to honor drafts drawn by the beneficiary.

Letters of credit may be classified also according to their terms and conditions. If a bank agrees to honor drafts drawn by the exporter only when accompanied by satisfactory bills of lading, consular and commercial invoices, the statement is called a documentary letter of credit. It is termed a clean or "open" credit if such stipulations are not mentioned.

A broad basis of classification of letters of credit rests on the right of the issuing bank to rescind its engagement to honor drafts drawn by the beneficiary. If the credit-issuing bank reserves the right to withdraw from the undertaking, the document is styled a "revocable" letter of credit. The "irrevocable" letter of credit contains a definite engagement on the part of the issuing bank to honor drafts drawn by the beneficiary in accordance with the terms and conditions specified in the letter. This engagement may not be canceled by the issuing bank prior to the expiration date without the consent of the beneficiary. The "irrevocable" letter of credit may be strengthened further by having the notifying bank in the same country as the exporter add its unqualified assurance that it will pay or accept the bills drawn by him even if the foreign bank should refuse to honor them. It is then called a "confirmed" export letter of credit. Expressing, therefore, both the definite undertaking of the issuer and also of the notifier, it is actually an "irrevocable-confirmed" letter of credit. Where the notifying bank does not add its guaranty, the credit is described as "unconfirmed," since the advising bank maintains that it is merely transmitting the information of the credit to the beneficiary without incurring liability for its continuance. Thus three classes of letters of credit may exist: (1) Irrevocable by the issuer and confirmed by the adviser; (2) irrevocable by

the issuer but unconfirmed by the adviser; (3) revocable by the issuer and also unconfirmed by the adviser.¹

This classification is a departure from the usual precept that the terms "confirmed" and "irrevocable" are synonymous as applied to commercial credits. However, while writings on this subject accept the twofold grouping of confirmed or irrevocable as against unconfirmed or revocable credits, actual banking practice operates on the classification given above.

. . . From this review of British decisions on the commercial letters of credit, the following principles may be deduced:

1. A letter of credit is not a negotiable instrument.
2. It does not create a trust fund in favor of the beneficiary.
3. An issuer of a letter of credit may not dishonor drafts presented by a negotiating bank under a clean irrevocable letter of credit if all the terms of the credit are fulfilled.
4. An issuer may dishonor bills drawn in violation of the conditions specified in a documentary letter of credit.
5. The negotiator is not liable for the genuineness either of goods or documents.
6. The issuer is responsible to the party requesting the credit for the observance of the conditions by the beneficiary.
7. The contract between the issuer and the beneficiary is entirely independent of the contract of sale between the buyer and seller, and the issuer cannot, because of the seller's breach of the contract of sale, refuse to honor drafts which comply with the terms of the letter of credit.

Recent American Cases on Commercial Letters of Credit.

Three recent American cases, one decided by the United States Circuit Court of Appeals, Second Circuit, and two decided by New York courts, have gone far toward establishing as a part of the law of this country the principles laid down in the foregoing British decisions as to the respective rights and liabilities of parties to commercial letters of credit.

The case of *American Steel Company v. Irving National Bank*, 266 Fed., 41 (C. C. A., 2d Circuit, Apr., 1920), holds that the beneficiary of an irrevocable letter of credit has an absolute right to have the drafts honored by the issuing bank when drawn in accordance with the terms of the letter, and that the issuing bank cannot decline to honor drafts so drawn, even though requested to do so by its customer, because the

¹ For definitions and classifications of letters of credit see (British) *Journal of the Institute of Bankers*, vol. 35, p. 74, vol. 41, p. 55 (Feb., 1920). Thomson, *Dictionary of Banking*, p. 356; *Trading with the Far East* (Irving National Bank), p. 81; *Handbook of Finance and Trade with South America* (National City Bank), p. 7; Escher: Margraff, Spalding, "Foreign Exchange and Foreign Bills," ch. 15; Whitaker, "Foreign Exchange," p. 131 *et seq.*

contract of sale between that customer and the beneficiary has become impossible of performance. In that case the defendant national bank had issued an irrevocable letter of credit to the plaintiff steel company authorizing the plaintiff to draw at sight upon the national bank for account of the defendant MacDonnell Chow Corporation for \$43,000 covering the shipment of tin plate. The plaintiff steel company had contracted to sell the tin plate to the defendant MacDonnell Chow Corporation f. o. b. Pittsburgh for export. The plaintiff shipped the tin plate and presented a sight draft to the defendant national bank with certain documents and the defendant national bank declined to honor the draft. The second defense alleged that by reason of the Federal prohibition against the export from the United States of tin plate the performance of the contract between the plaintiff and the defendant MacDonnell Chow Corporation became impossible of execution. The third defense alleged a resale by the plaintiff of the tin plate and claimed an offset of the amount realized on the resale. As to the second defense, Circuit Judge Rogers said:

The second defense, that the contract became impossible of execution, inasmuch as the MacDonnell Corporation was unable to obtain a license from the United States Government permitting the export of tin plate, is wholly inconsequential. The liability of the bank on the letter of credit as agreed upon between plaintiff and defendant was absolute from the time it was issued, and it was quite immaterial whether the defendant could export the tin or not. The law is that a bank issuing a letter of credit like the one here involved cannot justify its refusal to honor its obligations by reason of the contract relations existing between the bank and its depositor.

The opinion then cites with approval the case of *Sovereign Bank of Canada v. Bellhouse, Dillon & Co. (Ltd.)* upon the point that the customer at whose instance a bank has issued an irrevocable letter of credit cannot compel the bank to cancel that letter, since the letter constitutes a contract between the issuing bank and the beneficiary. The opinion concludes:

The defendant in effect seeks to read into the contract a provision that the plaintiff's rights under the letter of credit should be subject to the superior right of the MacDonnell Chow Corporation to modify the contract which the bank has made with the plaintiff. We do not so understand the law.

The case of *Frey & Son (Inc.) v. Sherburne Company* and the *National City Bank*, 184 New York, Supp. 661 (Appellate Division, N. Y. Supreme Court), expressly holds that the contract between the issuing bank and the beneficiary, as evidenced by the letter of credit, is entirely independent of the contract of sale between the buyer at whose instance the letter of credit was issued and the seller who is the beneficiary under the letter of credit, and that the issuing bank cannot repudiate its

contract with the beneficiary merely because of a breach of the contract of sale. The facts in that case were that the plaintiff had agreed to buy from the defendant Sherburne Company 350 tons of sugar to be shipped from Java; payment for the sugar to be made in New York on presentation of warehouse receipt or delivery order and the plaintiff to furnish an irrevocable letter of credit for the full amount of the invoice. The contract also provided that the plaintiff, the buyer, should have the right to cancel the contract in the event that the shipment was delayed. At the instance of the plaintiff the defendant national bank issued a letter of credit to the Sherburne Company authorizing that company to draw sight drafts upon the bank accompanied by specified documents covering the shipments of sugar. The letter of credit also contained a provision whereby the bank agreed with *bona-fide* holders that all drafts issued in accordance with the letter would be honored upon presentation. The letter did not, however, refer to the plaintiff's right to cancel the contract of sale if shipment was delayed. The plaintiff alleged that the shipment of 45 tons of the sugar had been delayed and that he had elected to cancel his contract for the purchase of so much of the sugar and that notwithstanding this the defendant Sherburne Company threatens to negotiate or present for payment drafts drawn under the letter of credit and that the defendant national bank threatens to pay such drafts if so presented or negotiated. The relief sought by the plaintiff was an injunction restraining Sherburne Company from drawing or negotiating drafts under the letter of credit and enjoining defendant national bank from honoring or paying drafts which have been or may be so drawn. In the opinion, Mr. Justice Greenbaum says:

From our view of the case it is not important to discuss the rights of the plaintiff under the contract with the defendant Sherburne Company. . . .

It is equally clear that the bank issuing the letter of credit is in no way concerned with any contract existing between the buyer and seller. The bank is only held liable in case of a violation of any of the terms of the letter of credit. It therefore would follow that, if the bank issued any drafts violative of the terms of the letter, the buyer would have recourse to the bank in an action for damages for the breach of its contract. Similarly, if the defendant Sherburne Company violated its contract with the plaintiff, the latter has a remedy in an action at law for damages against the defendant. It is not alleged in the complaint that the National City Bank is in financial difficulties. Nor is it alleged that the Sherburne Company is not financially able to respond to damages. Our attention has been called to *Higgins v. Steinhardter* (106 Misc. Rep. 168; 175 N. Y. Supp. 279). We are of the opinion that the facts appearing in the opinion of that case did not warrant the granting of an injunction. Interests of innocent parties who may hold drafts upon the letter of credit, should not be made to suffer by reason of rights that may exist between the parties to the contract of sale in reference to which the letter of credit was issued. It would be a calamity to the business world engaged in transactions of the kind mentioned in this complaint, if for every breach of a contract between buyer and seller a party

may come into a court of equity and enjoin payment on drafts drawn upon a letter of credit issued by a bank. The parties should be remitted to their claims for damages in an action at law.

To the same effect is the case of *El Reno Grocery Company, etc., v. Lamborn, et al*, reported in the *New York Law Journal* for December 15, 1920, in which Mr. Justice Cohalan of the Supreme Court of New York said:

There are before the court 24 motions for injunctions *pendente lite* in equity cases brought for the cancellation of certain contracts for the sale of sugar which the plaintiffs have attempted to rescind. The decision on this application is decisive of the 23 other motions. To enjoin the defendants from collecting upon a letter of credit established in their favor, because the plaintiff alleges there is a dispute, default or breach by the defendants of the contract is for the court to make a new, different and distinct agreement between the parties herein. This the court is not prepared to do. In my opinion the plaintiffs have an adequate remedy at law and there are no substantial reasons shown for invoking the extraordinary remedy of an injunction order. The plaintiff's motion is denied and the injunction vacated.

Forms of Commercial Letters of Credit.¹

*Adapted from the Federal Reserve Bulletin, vol. 7, pp. 410-415
(April, 1921).*

A preceding article has set forth the legal aspects of the commercial letter of credit and also the practice of a number of American banks.² In connection with this survey, the credit letters used by American banks were gathered and the following is a study of the features of difference and similarity among these letters, with a view of deriving principles which will be of advantage in standardizing the forms. This study will include a presentation of the various expressions found in 64 import and 56 export letters of credit and then a comparative analysis.

In its general form, the commercial letter of credit possesses all the characteristics of the ordinary business letter. The name of the beneficiary to whom the letter is directed appears in the usual place of the addressee. The date, name, and location of the issuing bank are all written above, and the signature of one or more officers appears below. While letters of credit vary extensively, the content depends upon whether the letter covers an import or export transaction, and hence it is necessary to study these documents on this basis of division. They all, however, contain an expressed or implied agreement on the part of a bank to honor the drafts of the seller of the goods and also a statement of the conditions which he must observe.

¹ Prepared under the direction of George W. Edwards, Division of Analysis and Research.

² FEDERAL RESERVE BULLETIN, February, 1921, pp. 158-171.

A. Import Letters of Credit.

In most import credits, the undertaking of the bank is expressed, first, in an authorization to the beneficiary to draw drafts to a certain amount and, second, in a general promise to holders of such bills that they will be duly honored. The credit also describes the required documents and states the time within which the conditions must be fulfilled. An analysis of the import letter of credit must, therefore, cover the following phases:

- (1) Heading.
- (2) Address to the beneficiary.
- (3) Promise to honor drafts.
- (4) Description of documents.
- (5) Date of expiration.
- (6) Supplementary expressions.
- (7) Reverse side of credit.

(1) Heading.

(1) Credit	5
(2) Letter of credit	34
(3) Commercial letter of credit	17
(4) Commercial credit	1

Most import forms bear a caption which states definitely that the document is a "letter of credit" or in full a "commercial letter of credit" to distinguish it beyond doubt from the traveler's letter. Few letters contain the words "irrevocable" or "confirmed" or in fact any single word which definitely expresses the particular class of the credit, since it is generally irrevocable.

(2) Address to the Beneficiary.

- (1) We hereby authorize you to draw on —.
- (2) We hereby authorize your drafts on —.
- (3) You are hereby authorized to draw on —.
- (4) You are hereby authorized to value on —.
- (5) We hereby authorize you or any parties whom you may direct by written order.
- (6) We hereby authorize you or your assigns.
- (7) We hereby authorize you or order.
- (8) We hereby establish our documentary credit.
- (9) We hereby open a credit.

As most import letters of credit confer a direct authorization to draw drafts upon a bank, the addresses made to the beneficiaries differ only in minor detail. No. 1 is a definite mandate from the issuing bank; No. 2 is more liberal toward the beneficiary, for his right to draw

drafts under partial shipments is given some recognition. The mandate in No. 3 is slightly weakened by not mentioning explicitly the party, whether issuing or paying banker, who has authorized the drawing of the drafts. Many British and a few American credits contain the expression "to value on" (see No. 4), but its legal and economic connotation is not as definite as the word "draw," which needs little explanation. A few banks frame their address so that the beneficiary may freely assign the credit to anyone whom he may choose. In letters used by a few western banks, the address to the beneficiary assumes forms exemplified in Nos. 8 and 9. Such statements of establishing or opening credits are generally found in export letters, but are ill-suited to the import credit which should give the addressee an unqualified authority to draw drafts on the bank.

The tenor and amount of the drafts may be described thus: "By your drafts at (30, 60, 90 days, sight) for not exceeding ——— dollars United States currency (\$———)." This expression, by implication at least, permits the drawing of the sum not only in one but also in several drafts if the beneficiary is so disposed. This is of decided advantage to him, for he is then enabled to draw several drafts of smaller amounts whenever it becomes difficult to negotiate a large single bill, and also his right to effect partial shipments is recognized. As the addressee must know the name of the importer for whom the bank is acting, it is customary to state that the drafts are authorized "for the account of ———." This expression may also read "by order of ———" or "at the instance of ———." Since bills are not always drawn to the full amount of the invoice but at times only to a certain percentage of the value of the merchandise, the letter of credit contains an expression which then reads "for ——— per cent invoice cost of ———."

(3) Promise to Honor Drafts.

(1) We hereby agree with the drawers, indorsers, and *bona-fide* holders of drafts drawn under and in compliance with the terms of this credit that the same shall be duly honored upon presentation at the office of ——— Bank, New York.

(2) We hereby agree that such bills as you may draw by virtue of this credit shall meet with due honor upon the presentation at the office of ——— Bank.

(3) We hereby engage that drafts in compliance with the terms of the credit will be duly honored.

(4) We hereby request our correspondents and others, to negotiate drafts under this credit, and we engage that all such drafts will meet with due honor upon presentation upon us.

(5) ——— Bank engages that bills so drawn, shall be accepted on presentation and paid at maturity.

As one purpose of the letter of credit is to aid the exporter in nego-

tiating his drafts, the issuing banker addresses to all holders of these bills a general promise that they will be honored on presentation. This engagement on the part of the issuer appears as the closing statement of the credit and assumes one of the expressions presented above. These forms convey essentially the same thought and differ only as to the number of the addressees. No. 1 includes "drawers, indorsers, and holders"; 2 limits its promise to "drawers" only; while 3 and 4 omit all reference to parties. In 4 the bank requests only its "correspondents to negotiate drafts" of the beneficiary and assures them that they will be reimbursed. No. 5 is more specific than the others in defining the obligation of the bank by stating that it will both accept and pay the drafts.

(4) Description of Documents.

The survey thus far indicates that the letter of credit is an undertaking in which a bank authorizes an exporter to draw drafts and promises to pay them at maturity. On the other hand, the exporter, as the second party, agrees to draw his drafts only in accordance with certain conditions which are specified with greater detail in documentary than in clean credits. In formulating such letters of credit, the bank must seek to eliminate responsibility for the merchandise and participation in the commercial risk. The bank cannot be expected to guarantee facts relating to time of shipment and quality of goods, but can only be held accountable for the regularity of the documents evidencing the fulfillment of the terms prescribed in the credit. Letters of credit enumerate the usual shipping documents such as bills of lading, policies or certificates of insurance, commercial and consular invoices. As the bill of lading must be negotiable in form, it is filled out to the order either of the bank or of the shipper and indorsed by him in blank. Sometimes "on board" bills of lading are demanded and then the credit includes expressions which read "that payment under this credit will only be made provided the goods are actually on board, or loading on the vessel named in the bills of lading." Insurance in most cases is made payable to the bank and the credit ordinarily stipulates whether the insurance is to be effected by importer or exporter. Policies, of course, must be issued by reputable companies and be sufficient in amount to cover all losses. Commercial invoices are always demanded and at times must be in triplicate. All these documents should be in strict conformity with the terms of the credit and satisfactory to the issuing bank. A few American banks have adopted a British practice which requests negotiators to certify that the conditions have been observed and in one instance this guaranty reads as follows: "Your negotiation

of any draft or drafts under this letter of credit will be considered a guarantee to ——— Bank that the terms and conditions expressed therein have been fulfilled." A requirement of this nature charges the negotiator with a very definite responsibility and may render it difficult for the beneficiary to secure a buyer for the drafts. One far-eastern bank exacts a guaranty not from the negotiator but from the beneficiary himself who is called upon to sign the following statement:

We beg to hand you the undermentioned drafts with shipping documents attached, for negotiation. We herewith declare that these drafts and documents have been made out in strict conformity with terms concerned and agree to hold ourselves responsible therefor.

The disposition of the various documents required under a letter of credit is indicated by the following table:

	Negotiator to send direct to issuer.	To send with drafts.
Bill of lading	51	48
Consular invoice	47	12
Commercial invoice	26	47
Insurance certificate or policy	5	6

It is evident from the above that the negotiator forwards directly to the issuer the bill of lading and a consular invoice, while the commercial invoice and remaining documents, including duplicates, are later transmitted with the drafts drawn by the exporter.

(5) Date of Expiration.

- (a) Date of credit.
 1. Expiration date.
 2. Available until ———.
 3. This credit becomes void if not used on or before ———.
- (b) Date of draft.
 1. Drafts under this commercial letter of credit must be drawn prior to ———.
 2. Drafts drawn under this credit must be drawn and negotiated prior to ———.
 3. ——— if negotiated prior to ———.
- (c) Date of bill of lading.
 1. Bills of lading must be dated on or before ———.
- (d) Date of credit and draft.
 1. This credit expires on ———. Your draft must be presented on or before this date.
- (e) Date of shipment and draft.
 1. The shipments must be completed and drafts drawn on or before ———.
 2. Shipments must be completed and the drafts negotiated on or before ———.

(f) Bill of lading and draft.

1. Bills of lading must be dated not later than ——— and drafts must be drawn not later than ———.

Date of credit	9
Date of draft	25
Date of draft and bill of lading	4
Date of draft and shipment	23

Type (a) is not widely used, as there is always doubt whether the credit expires at the office either of the negotiating or the credit-issuing bank. The exact termination of a credit is fixed by the close of the business, usually at 3 o'clock on week days or 12 on Saturdays. If the expiration date falls on a Sunday or a holiday, it is the practice to consider the credit still available on the next business day. No. (b)—1 does not fully protect the interest of the issuer, since it is possible for a beneficiary to postdate his drafts. (b)—2 overcomes this defect by compelling the beneficiary not alone to draw but to present his drafts for negotiation before a fixed date. Type (d) has the advantage of determining one date for both the expiration of the credit and the presentation of the drafts; (e) in similar manner joins the date of shipment with the drawing of the drafts, while (f) binds together the dates of the bills of lading and of the drafts.

(6) Supplementary Expressions.

(a) Description of the draft.

(1) All drafts drawn under this credit must be marked "drawn under ——— Bank, credit No. ——— dated New York ———."

(2) Drafts against this credit may be marked "payable if desired at maturity at the ——— Bank, New York."

In order to simplify their records, it is customary for banks to have the beneficiary note upon his draft that it has been drawn under a particular letter of credit. [See No. (a)—1.] Occasionally a beneficiary finds difficulty in negotiating drafts drawn under a letter of credit issued by an interior American bank. This institution in order to expedite the discounting of its drafts abroad then induces its New York correspondent with an international reputation to permit an inscription similar to No. (a)—2.

(b) Return of the letter of credit.

This credit is to be attached to the last bill drawn under it or returned when its currency has expired.

An expression similar to the above appears on many letters of credit, but responses to question 3 indicate that the originals seldom find their way back to the issuers.

(7) Reverse Side.

Space is usually allowed on the reverse side of credit letters for negotiators to indorse the particulars of the drafts which they have purchased. As foreign banks do not make it a practice of marking off the details of bills thus discounted, one American bank safeguards itself against such omission by inserting the statement on its letter of credit that "the amount must be indorsed hereon and the negotiation of any draft is considered a guaranty that such indorsement has been made." In general the opposite side of the credit may call for the following details: (a) date of payment; (b) name of negotiator; (c) name of town where negotiated; (d) amount in words; (e) amount in figures. To prevent overpayment one bank adds the clause that "the amount drawn against this credit is not to exceed ——."

B. Export Letters of Credit.

Pursuing the same general method of presentation as used above, export letters may be analyzed according to the following characteristics:

- (1) Heading.
- (2) Address to beneficiary.
- (3) Description of documents.
- (4) Date of expiration.
- (5) Supplementary expressions.

As confirmed and unconfirmed credits are quite similar in content, the former will be analyzed in detail and features peculiar to the latter will then be viewed.

(1) Heading.

	Terms used in heading.	Confirmed.	Unconfirmed.
Credit		14	10
Letter of credit		2	3
Advice of credit		4	5

From the above table it appears that banks have no settled usage as to the terms "irrevocable" or "revocable" and "confirmed" or "unconfirmed," and consequently a bank is oftentimes at a loss how to interpret the cable instructions of foreign correspondents requesting the opening of credits. To avoid this confusion, it may be advisable to adopt the words "revocable" and "irrevocable" when referring to import credits and the terms "unconfirmed" and "confirmed" in mentioning export credits.

The above table indicates that the term "letter" is seldom applied to export credits, but instead the word "credit" or the phrase "advice of

credit" is generally applied. This is most likely due to the thought that banks, apprising beneficiaries of the opening of export credits, are not assuming actual, primary obligations of their own, but rather secondary responsibilities contingent only upon the default of their correspondents abroad. The security of this belief depends entirely upon the phraseology of the notice which the bank addresses to the beneficiary of the export credit.

(2) Notice to the Beneficiary.

(a) Actual authorization to draw upon notifying bank.

- (1) We hereby authorize you to draw upon us.
- (2) You are hereby authorized to draw on us.

(b) Potential authorization to draw upon notifying bank.

- (1) We beg to inform you that we have been authorized by _____ to negotiate your drafts on us.
- (2) We are instructed by _____ to pay you to the extent of _____.
- (3) We are informed by _____ that you will draw upon us at _____.

(c) Advice of an actual credit opened by notifying bank.

- (1) We herewith open a confirmed credit in your favor.
- (2) We have opened a confirmed and irrevocable credit.
- (3) Please note that a confirmed credit has been opened with us in your favor, for account of _____.
- (4) We are informed by _____ that they have established a credit with us in your favor.
- (5) Please note that under instructions from our principals we hereby open a confirmed credit in favor of _____.
- (6) We hereby confirm the following credit opened at the request of _____.

(d) Advice of potential credit opened by notifying bank.

- (1) We are pleased to inform you that we have been requested to open a credit in your favor.
- (2) We beg to intimate that we have issued a commercial letter of credit.

(e) Advice of actual credit opened by issuing bank.

- (1) We are to-day in receipt of (cable) advices from _____ that they have issued an irrevocable credit.
- (2) We advise you that said bank has opened a confirmed credit.
- (3) _____ have requested us to advise you that they have opened a credit.

Types of notifications in American letters of credit.

	Confirmed. Unconfirmed.	
a. Actual authorization	3	1
b. Potential authorization	3	9
c. Actual credit opened by notifier	8	9
d. Potential credit opened by notifier	3	6
e. Actual credit opened by issuer	3	6

(a) The direct authorization as seen in forms 1 and 2 constitutes a definite mandate from the bank to the beneficiary. No. 1 is the most forceful expression of a bank's obligation under an export letter of credit, while No. 2 is somewhat weaker in that it leaves the beneficiary in doubt whether the authorization to draw emanates from the issuing or the notifying bank. These forms are well adapted to the import credit letter which is the direct, primary obligation of the issuer, but they fail to express the true position of a bank which is merely acting as the representative of its foreign correspondent. A few banks issue the same form for both import and export credits, and in fact one bank uses a single document for all credits by merely adding the expression "unless previously canceled" to its revocable and unconfirmed letters.

(b) In order to retain the thought of direct authorization and at the same time not to bind the notifying bank too closely, export letters frequently contain the second type, which is merely a potential authorization to the beneficiary. He is notified that the bank has been instructed to pay him or informed that he will draw, but in no case does the bank admit that it will heed the instruction or honor the drafts when drawn. These expressions extend to the beneficiary only the possibility of payment, and hence may be described not as actual but only potential authorizations. In fact, No. 3 follows the language of the document known as the "authority to purchase" rather than the letter of credit.

(c) Group (c) conveys the true function of a notifying bank which is expected to add its confirmation to a credit already opened by a foreign bank. As a matter of fact, there is little to choose between actual authorizations and these expressions, since they all indicate in no uncertain terms that the credit is domiciled with the notifying bank. The recipient is fully assured that he has an undisputed claim upon the bank which has advised him of the credit. It is, therefore, well adapted to a confirmed credit but ill-suited as an unconfirmed form.

(d) Form (d) is not a direct notice of credit opened by the notifying bank and in fact is nothing more than a mere advice of a potential credit. The bank issuing (d)-1 would probably contend that it has assumed no undertaking, since it has not agreed to accede to the request of its correspondent for the opening of a credit. In (d)-2 the bank, using the guarded term "intimate," rather cautiously imparts to the beneficiary the knowledge of a credit opened in his behalf.

(e) Type (e) includes advices of actual credits opened by another bank. The notifying bank simply transmits certain information to the beneficiary and undertakes no engagement whatsoever. Even the inser-

tion of the word "confirmed" fails to transform this statement into a credit domiciled with the notifying bank. These forms are therefore not adapted to describe the obligations of the informing bank under a confirmed letter of credit. A certain bank draws a nice distinction between types (c) and (e) by describing the former as a "confirmed letter of credit" and the latter as an "advice of confirmed credit established."

In conclusion, some form of type (c), an advice of an actual credit opened by the notifying bank, best expresses the actual principle of a confirmed export letter of credit, while type (e), an advice of an actual credit opened by another bank, conforms to the true theory of an unconfirmed credit.

(3) Documents.

Export letters of credit call for delivery of the usual commercial set of documents which have been described above in the analysis of import credits. These must be complete, which may mean duplicate or triplicate sets. It is generally added that documents must be of a character satisfactory or acceptable to the bank effecting payment. Such phrases offer wide latitude to banks in rejecting documents not in conformity with the conditions of the credits.

(4) Expiration Date.

(a) Date of credit:

1. This credit will remain in force until ———.
2. Available until ———.
3. Expires.
4. Expiring in New York.

(b) Date of draft:

1. Drafts drawn under this credit must be presented not later than ———.

(c) Date of credit and draft:

1. This credit expires on ———. Your draft must be presented on or before that date.
2. Available by drafts on us, at ———, which must be presented on or before the expiration date of this credit.

(d) Date of shipment and draft:

1. All shipments must be completed, and drafts with full sets of documents must be presented for payment not later than ———.
2. (Drafts) should be presented to our foreign department on or before ———, the date this credit expires.

	Confirmed.	Unconfirmed.
(a) Date of credit	14	22
(b) Date of draft	6	6
(c) Date of credit and draft	3	0
(d) Date of draft and shipment	1	1

The objection raised above, that type (a) does not define the exact place of the expiration of the credit is partly overcome by one bank which describes the credit as "expiring in New York" on a certain day and this implies that both drafts and documents must be presented at the counter of the negotiating bank before the fixed date [see (a)-4]. Type (b) is seldom used, but is often combined with (a) to form type (c) which fixes one date for both the expiration of the credit and the presentation of the drafts to the negotiating bank. Some banks insist that shipments be completed and drafts drawn before a certain date matures. Where a credit reads "December shipment" the negotiating bank generally allows presentment of documents until January 5.

(5) Supplementary Expressions.

The export credit is usually concluded by an explanation of the notifying bank's relation to the issuing bank and the beneficiary. The statement is made that, as the advising bank is merely acting as representative of its foreign correspondent, it must therefore insist upon strict conformity with the terms of the credit. If the conditions are unsatisfactory to the beneficiary, he is told to communicate before making shipment, either with the bank notifying him of the credit or with the party importing the goods, in order to secure the necessary modifications. A typical instruction reads thus:

As our foreign correspondents are inclined to be extremely technical in connection with payments against shipping documents, we must insist upon the conditions stated herein being complied with to the letter. If the terms of this credit are incorrect or unsatisfactory, please communicate directly with your principals abroad and ask them to have our correspondents send us amended instructions.

It will be observed that several features common to import letters are lacking in export credits. Banks do not indorse particulars of negotiated drafts on the reverse side, nor do they request the beneficiary to return the credit. These practices are not essential in the case of export credits, since they are usually payable only at the bank establishing them. It was observed above that most import credits contain a concluding declaration in which the issuing bank affirms to all holders of the drafts that they will be duly honored. Such a statement is rarely found in the export credit and, in fact, is unnecessary, as the letter

serves merely to inform the beneficiary of the opening of the credit and not to aid him in the selling of his drafts.

(6) Expressions Indicating Unconfirmed Credits.

1. In advising you that this credit has been opened we are acting as the representatives of our foreign correspondents and do not assume any responsibility for its continuance.

2. Please note that this is an unconfirmed credit and is consequently subject to modification or cancellation.

3. As this is an unconfirmed credit, it is subject to cancellation at any time, with or without notice to you.

4. We have no authority from our clients to confirm this credit or to guarantee the acceptance (payment of drafts drawn against it). The credit is therefore subject to cancellation without notice.

5. Kindly note that this is not a confirmed credit, and is consequently revocable at any time, either by the parties granting the credit, or by ourselves under certain conditions.

6. In the absence of any statement to the contrary, ——— assumes no obligations whatsoever, even if all the conditions of the credit have been complied with.

An unconfirmed credit usually bears either a caption or a statement in the body of the letter using the terms "unconfirmed" or "revocable." Some banks define their position under an unconfirmed credit by stating that they are acting as agents of their foreign correspondents and in extending the credit have incurred no obligation to the beneficiary (see No. 1). It is customary also to express the right to nullify the credit (see No. 2). Some banks transform their confirmed credits into unconfirmed forms simply by adding the statement that the credit expires on a certain date "unless previously canceled." By inference the beneficiary is entitled to notice of such cancellation, but many banks inform him that the right of cancellation may be exercised either "with or without notice" (see Nos. 3 and 4).

Practice Under Commercial Letters of Credit.¹

*Adapted from the Federal Reserve Bulletin, vol. 7, pp. 681-688
(June, 1921).*

Introduction.

The following study is the third of a series dealing with the methods of financing foreign trade. Previous articles, appearing in the Federal Reserve Bulletin for February and April, 1921, have discussed such phases of the commercial letter of credit as its legal principles, its use by American banks, and also the various forms it assumes. These

¹ Prepared under the direction of George W. Edwards, Division of Analysis and Research.

studies have analyzed the subject from the standpoint of the banker, while the following article is an exposition of commercial credits from the view of the American exporter and importer. The purpose is to present typical opinions on unsettled questions relating to commercial credit practice, in order to develop certain principles which may find general acceptance among parties interested in the financing of foreign trade. The material has been gathered partly by direct personal interview, but mainly through questionnaires addressed to leading commercial houses. In this task, the Division of Analysis and Research secured the co-operation of such organizations as the National Foreign Trade Council, New York Merchants' Association, National Association of Manufacturers, Philadelphia Commercial Museum, Chamber of Commerce of the State of New York, and the United States Chamber of Commerce. The questionnaire has sought to elude replies on such subjects as the meaning of the letter of credit, the use of the document by commercial houses, and the general policy to be followed in further developing American credits. The data thus assembled are presented in the following general form: (1) Statement of the question; (2) tabulation of the replies wherever possible; (3) excerpts from answers presenting typical viewpoints; (4) interpretation of these answers.

I. Meaning of Letter of Credit.

I.

Question: Do you draw a distinction between a "confirmed" and "irrevocable" and an "unconfirmed" and "revocable" letter of credit?

The purpose underlying question 1 was to secure an expression of opinion on the correct classification of letters of credit. This topic has not a mere academic interest, but possesses an important legal significance, for it affects directly the liability of the various parties to a letter of credit. Answers (a) and (b) both hold the view that the terms "confirmed" and "irrevocable" are synonymous, and that no distinction exists between these two types of credits. Letters of credit would thus be grouped as (1) confirmed or irrevocable, (2) unconfirmed or revocable. On the other hand, answer (c) discriminates between the words confirmed and irrevocable, and this view results in the threefold classification of (1) confirmed—irrevocable, (2) unconfirmed—irrevocable, and (3) unconfirmed—revocable. The opinions of American banks were sought in a previous questionnaire relative to this subject, but a presentation of their replies has been deferred until this issue of the Bulletin, in order to permit a more detailed treatment. The results were as follows:

Question: Do you issue to a beneficiary an export letter of credit which is irrevocable by the foreign bank but still unconfirmed by you?

It is therefore clear that a distinction must be drawn between an irrevocable and a confirmed letter of credit. The irrevocable letter of credit is a document in which a foreign bank promises to honor the drafts of the beneficiary, provided he complies with certain conditions stated in the letter, and it is an obligation absolutely binding upon the issuing institution. This credit may be sent directly by mail to the exporter, or it may be transmitted by cable to a correspondent bank, which in turn informs the favored party of the credit. This report is conveyed without the assumption of any liability by the informing bank. However, if the notifier, at the request of the issuer, adds its guarantee or confirmation to the advice addressed to the beneficiary, it then becomes an engagement binding upon both banks. In other words, one credit is irrevocable by the issuer but unconfirmed by the notifier, and the other is both irrevocable by the issuer and further confirmed by the notifier.

There remains the third form which is revocable by the issuer and unconfirmed by the notifier. Regarding this form, answer (d) is quite correct in contending that such notice does not constitute a true letter of credit, for the document is the obligation neither of the issuing nor of the notifying bank, and hence cannot be described as a "credit." This document should be termed rather a "letter of advice." It serves a definite trade purpose especially in financing shipments from agents, affiliated concerns or firms which, of course, would not cancel their obligations. Most banks do not issue these revocable letters of advice.

2.

Question: In the case of an unconfirmed credit stating on its face, "subject to cancellation," issued in your favor, up to what time is it your understanding that the issuing bank has the right to cancel?

From the above analysis it is apparent that a bank has the right to cancel a revocable letter of credit, but the exact time within which this privilege may be exercised remains undefined. As indicated in the Federal Reserve Bulletin for February, 1921, page 170, the cancellation order from bank to exporter may possibly be made effective before any one of the following successive stages in the financing of a shipment: (1) Completion of manufacture of the goods; (2) delivery of goods to a carrier as evidenced by railroad or ocean bills of lading; (3) presentation of these documents at the office of the bank which has informed

the beneficiary of the credit; (4) negotiation of the beneficiary's drafts by this bank.

Although the majority of the replies concede that banks have the right to cancel a letter of advice at any time, the more discerning exporters assert that such action may not be taken after the presentation of shipping documents at the counter of the bank negotiating their drafts. Bankers, on the other hand, generally insist that they may cancel an advice of a credit at any time before they have actually negotiated the drafts of the beneficiary. The equitable view between these divergent contentions recognizes that the exporter has definitely fixed the liability of the issuing bank if his shipping documents, complying with the terms of the advice, are tendered to the notifying bank before the letter has given either an oral or written notice of the cancellation.

3.

Question: What in general has been your experience with unconfirmed revocable credits?

From the above replies it is apparent that a large proportion of commercial houses do not use unconfirmed credits because of their uncertain nature as described under question 2. On the other hand, it seems that the experience of firms which do avail themselves of this form of credit has been quite satisfactory, due probably to the fact that such letters are accepted only from banks and customers of recognized standing.

4.

Question: In selling drafts drawn against a letter of credit, do you consider that the buying bank has recourse to you?

- (a) On a confirmed credit.
- (b) On an unconfirmed credit.
- (c) On an irrevocable credit.
- (d) On a revocable credit.

In addition to the question of cancellation of commercial credits, another mooted problem between exporters and bankers is the right of recourse to the party who has drawn a draft upon the authority of a commercial letter of credit. The Law of Negotiable Instruments recognizes fully the right of the drawer of a draft to place after his name the phrase "without recourse," which relieves him of the liabilities usually attaching to the drawer of the bill. The exporter who has presented for payment a draft bearing this expression insists that the entire business transaction so far as he is concerned is closed, and that the negotiating

banker may not in the future turn to him for reimbursement. It is therefore quite obvious that exporters regard with greater favor the drawing of drafts without recourse than with recourse to themselves. The question then arises, What is the recourse to the drawer of drafts under the various classes of letters of credit described above? One view is expressed in answer (a), which holds that the bank has absolutely no recourse against the drawer of the drafts, whether the credit be irrevocable or revocable, confirmed or unconfirmed. Answer (b) applies the principle of "without recourse" to the confirmed and to the irrevocable letters of credit, but not to the unconfirmed revocable form. Answer (c) confines the right to draw a draft without recourse solely to the recipient of a confirmed and irrevocable letter of credit. According to the numerical tabulation presented above, the exporter believes that confirmed and irrevocable letters of credit permit the beneficiary to draw his drafts without recourse to himself, but that unconfirmed revocable credits admit of recourse by the bank to the drawer. This middle view is not generally followed by the banks, which, in their replies to the same question, contend that the drawer of a bill of exchange is not released from his liability. In conclusion, under the Law of Negotiable Instruments, any *bona-fide* holder has full recourse upon the drawer of a draft under a letter of credit if the drawee bank dishonors the bill. Considering the question not from the strictly legal standpoint but from commercial usage, the drawer of drafts under a confirmed irrevocable letter of credit issued by a reputable bank may safely regard the transaction as closed upon acceptance by the drawee bank and he would be liable only in the extreme event of failure of the accepting bank. (See address of Wilbert Ward at Eighth National Foreign Trade Convention, May, 1921.)

5.

Question: Have you drawn under "Letters of authorization" (authorities to purchase), and if so, what has been your experience in connection with their use?

A shipment of goods in foreign trade may be financed by the importer either through a letter of credit or an "authority to purchase." The former document, as was noted above, vests the exporter with the right to draw drafts upon a bank. On the other hand, the authority to purchase instructs the shipper to draw his bill upon the importer directly, but assures him that the draft will be purchased by the notifying bank. From the above replies it may be observed that the authority to purchase is not widely used by American merchants.

II. Use of the Letter of Credit.

6.

Question: For what classes of transactions have you used letters of credit?

(a) Please indicate as many classes of import transactions as possible.

(b) Please indicate as many classes of export transactions as possible. In each kind of business indicate all of the variations occurring; *i.e.*, f. a. s., f. o. b., c. and f., c. i. f., also whether the credits have to be available before ocean documents are obtainable, and, if so, whether against warehouse receipts or on a clean basis, or whatever the terms may be. In case of an unusual transaction, please illustrate how they were handled.

The letter of credit is not extensively used to finance imports, but when so applied the terms are mainly f. o. b. and c. i. f. When a letter of credit has been issued in favor of the seller, payment may be made available at the several successive stages in the completion of the transaction. As indicated in answer (b), the beneficiary may receive his credit even before he has sent his orders to the factory or mill for executing the terms of the sales contract. The next step would be to move the finished goods to the seaboard, where they may be placed in a warehouse. Upon the surrender of warehouse receipts the shipper may at times receive payment. However, this practice obtains only under abnormal conditions such as embargoes, freight congestion, or a state of war. It is more usual for the negotiating bank to effect payment only upon receiving documents evidencing the actual placing of goods on the carrier. In general, a choice among these three points depends almost entirely upon the credit standing of the importer.

7.

Question: Have you used acceptance credits opened for your account in your own favor for —

(a) Transactions involving the importation of merchandise.

(b) Transactions involving the exportation of merchandise.

(c) Transactions involving domestic shipments.

(d) Transactions involving merchandise in warehouse? If so, did such credits meet the requirements of your business and give you the credit facilities desired; or, if not, explain in what respect they were found to be not available.

Acceptance credits are not widely used by American merchants. However, those firms which have availed themselves of this kind of credit ordinarily report satisfactory experience.

8.

Question: Have you found letters of credit useful in local or domestic transactions, and, if so, how have they been employed?

Letters of credit may be used in domestic transactions in two ways.

The American exporter as recipient of a letter of credit may request his bank to issue an ancillary letter in favor of a domestic manufacturer, who in turn supplies the necessary goods. A letter of credit may also be used to finance a purely domestic transaction, and this practice is finding favor among American sellers who thus seek to avoid cancellation of future contracts.

9.

Question: In case you open letters of credit, would you as a practice be willing to have the beneficiary assign them so that they would be available by a party unknown to you?

The replies were unanimous in stating that American importers do not permit foreign beneficiaries to assign credits opened in their behalf to other unknown parties.

10.

Question: Have you obtained loans or cash advances from your bank on the faith of letters of credit issued by that bank or another bank in your favor?

(a) Were such credits deposited with the bank and accepted by them as collateral?

(b) Did your bank merely require that they be exhibited to prove their existence?

It is not a practice of American exporters to use letters of credit opened in their favor as a form of collateral for receiving advances from banks.

III. Policy.

11.

Question: What in general has been your experience with dollar credits opened by banks in this country as compared with your experience with sterling credits issued by London banks?

The purpose of the remaining questions was to secure constructive criticism for the development of American credits. The majority of the answers express satisfaction with dollar credits, and in fact some replies indicate a preference for dollar over sterling credits. One reason, as stated in answer (a), is the advantage of being able to bring suit against the issuing bank in the event of default on its obligation. On the other hand, several responses compare sterling and dollar credits to the disadvantage of the latter as shown in answers (b), (c), (d), and (e). The criticisms levied against the practice of American banks can be summarized as follows: (1) Higher interest and commission charges; (2) inexperience in handling credits; (3) unwise extension of credit; (4)

restricted exchange market. The causes of these defects are apparent. The United States has entered only recently into the field of financing foreign trade and therefore commercial education is limited, credit information is lacking, and our acceptance market is still narrow.

12.

Question: What suggested changes as to practice have you had from your correspondents abroad in connection with letters of credit issued by banks in this country? Have they made any comparison of methods here with English methods?

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13.

Question: What in your opinion should banks in this country do:

- (a) To make dollar credits more effective?
 - (b) To hold and develop the letter of credit business here?
-

As both questions solicit expressions of opinion from American commercial houses and foreign correspondents on the one question of the relative value of American credits, the results can be summarized best by combining all replies. The first three answers offer suggestions as to the general policy of American banks. The recommendation contained in (a) has already been carried into effect by the Board's recent ruling permitting Federal reserve banks to purchase in the open market bills of exchange with a maturity of six months. It is urged that the discount market be broadened, and the number of branches in foreign countries extended (b) and (c). Answers (d) and (e) advise American banks to assume greater responsibility in their handling of commercial credits. These institutions are also asked to adopt a more liberal policy in applying and comparing the documents presented by the exporters with the terms stated in the credits (g) and (h). Mercantile houses are strong in support of the movement for attaining standardization in commercial credit forms and uniformity in practice (i), (j), and (k). Along these lines satisfactory progress has already been effected by committees representing the interests of banks and merchants.

Selected Sections from the Banking Laws of New York Governing Acceptance Corporations and Investment Companies.

§290. *Incorporation; Organization Certificate; Amount of Capital Stock.*

When authorized by the superintendent of banks, as provided by section twenty-three of this chapter, five or more persons may form a

corporation to be known as an investment company. Such persons shall subscribe and acknowledge and submit to the superintendent of banks at his office an organization certificate in duplicate which shall specifically state:

1. The name by which the investment company is to be known.
2. The place where its business is to be transacted.
3. That the investment company is, or is not, being organized for the purpose of exercising the powers set forth in subdivisions four and five of section two hundred and ninety-three of this chapter.
4. The amount of its capital stock and the number of shares into which such capital stock shall be divided, which capital stock shall amount to not less than one hundred thousand dollars, except that, if such investment company is being organized for the purpose of exercising the powers conferred by subdivisions four and five of section two hundred and ninety-three of this chapter, it may have a capital stock of not less than twenty-five thousand dollars if the place where its business is to be transacted is a city or village the population of which does not exceed fifty thousand, and a capital stock of not less than fifty thousand dollars if the place where its business is to be transacted is a city the population of which exceeds fifty thousand but does not exceed one hundred and fifty thousand.
5. The full name, residence and post-office address of each of the incorporators and the number of shares subscribed for by each.
6. The term of its existence, which may be perpetual.
7. The number of its directors, which shall not be less than five, and the names and addresses of the incorporators who shall be its directors until the first annual meeting of stockholders.

Such certificate may provide for the manner in which the stock of the corporation may be transferred and for the number of directors necessary to constitute a quorum.

§293. *General Powers.*

In addition to the powers conferred by the general and stock corporation laws, an investment company shall, subject to the restrictions and limitations contained in this article, have the following powers:

1. To sell, offer for sale or negotiate bonds or notes secured by deed of trust or mortgages on real property situated in this State or outside of this State, or choses in action owned, issued, negotiated or guaranteed by it; to advance money upon the security of such bonds, notes or choses in action; to purchase or otherwise acquire such bonds, notes or choses in action and to pledge them to secure the payment of collateral

trust bonds or notes; to sell or otherwise negotiate such collateral trust bonds or notes.

1-a. To accept bills of exchange or drafts drawn upon it payable on demand or on time not exceeding one year from the date of acceptance; to issue letters of credit authorizing the holders thereof to draw drafts upon it at sight or on time not exceeding one year from the date of any such letter of credit; to discount bills of exchange, drafts, notes, acceptances, or other choses in action; to buy and sell coin, bullion and exchange; to issue, at any branch office authorized by the superintendent of banks pursuant to section fifty-one of this chapter and established in a country or province of Asia in which the principal local currency consists of silver coin or bullion, notes payable in the local currency to bearer on demand without interest; provided, however, that the total amount of such notes issued by any such investment company and outstanding at any one time shall not exceed twice the paid-in capital of such investment company and that there shall be kept on hand at each branch office where such notes are issued a reserve in silver bullion or in the local silver coin of at least fifty per centum of the notes so issued at such branch office.

2. To receive money or property in installments or otherwise from any person or persons, with or without an allowance of interest upon such installments; to enter into any contract or undertaking with such persons for the withdrawal of such money or property, at any time, with an increase thereof, or for the payment to them or to any person of any sum of money at any time, either fixed or uncertain.

3. To engage in the business of receiving deposits, provided that it shall not engage in such business in this State until it shall have first made such deposit of securities with the superintendent of banks as is required of trust companies by section one hundred and eighty-four of this chapter.

4. To deduct interest in advance on loans at the rate of six per centum per annum provided such loans are secured by assignments of choses in action or other evidences of indebtedness issued by it and to be paid for in uniform monthly or weekly installments. To charge for a loan exceeding fifty dollars made pursuant to this subdivision one dollar for each fifty dollars or fraction thereof loaned for expenses including any examination or investigation of the character and circumstances of the borrower, co-maker or surety, and the drawing and taking the acknowledgment of necessary papers, or other expenses incurred in making the loan; provided, that no fee collected hereunder shall exceed five dollars; and provided that for a loan exceeding two hundred and fifty dollars, one per centum additional of the amount

loaned in excess of two hundred and fifty dollars may be charged for such expenses, not exceeding a total fee of twenty dollars. If any such loan made pursuant to this subdivision is fifty dollars or less, such charge shall not be more than one dollar. Whenever an additional loan shall be made to anyone borrowing within three months of the date of a previous loan, no further charge for examination, investigation, drawing of necessary papers and taking acknowledgments, shall be made against him under any pretext whatever. No such charge shall be collected unless a loan shall have been made as the result of such examination or investigation.

5. To impose a fine of five cents for each default in the payment of one dollar or a fraction thereof at the time any periodical installment upon a certificate assigned as collateral security for the payment of a loan made pursuant to subdivision four of this section becomes due, provided, however, that such fines shall not be cumulative; that the aggregate of such fines collected in connection with any such loan of fifty dollars or less or any renewal thereof shall not exceed one per centum of such loan and shall in no event exceed five dollars.

6. To establish branches pursuant to section fifty-one of this chapter.

§294. Restrictions on Powers of Investment Companies.

An investment company shall not

1. Exercise the powers conferred by subdivision one-*a* of section two hundred and ninety-three of this chapter, unless it shall have a paid up capital stock of at least two million dollars; exercise, within this State, the powers conferred by both subdivisions one-*a* and three of section two hundred and ninety-three of this chapter, or exercise the powers conferred by both subdivisions three and four or by both subdivisions one-*a* and four of section two hundred and ninety-three of this article.

2. Hold at one time the obligations of one person for more than five thousand dollars, secured by assignments of choses in actions or other evidences of indebtedness issued by it and to be paid for in uniform monthly or weekly installments.

3. Make any loan under the provisions of subdivision four of section two hundred and ninety-three of this article for a longer period than one year from the date thereof.

4. Deposit any of its funds with any other moneyed corporations unless such other corporation has been designated as such depository by a vote of a majority of the directors of the investment company, exclusive of any director who is an officer, director or trustee of the depository

so designated; provided, however, that this limitation shall not apply to the deposit of funds by an investment company with another moneyed corporation, which owns all or a majority of the capital stock of such investment company.

5. Be the holder of any shares of its own capital stock unless such stock shall have been taken to prevent loss upon a debt previously contracted in good faith, and stock so acquired shall, within six months from the time of its acquisition be sold or disposed of at public or private sale; nor shall it, either directly or indirectly, make any discount to any person for the purpose of enabling him to pay for or hold shares of its stock either subscribed for or purchased by him. Any investment company making any such discount shall forfeit to the people of the State twice the amount of such discount.

Suggested Readings on Chapter XIX.

Dewey, D. R., and Shugrue, M. J.—Banking and Credit, Chapters IV and V and XXVII to XXIX.

Furniss, E. S.—Foreign Exchange.

Edwards, G. W.—Foreign Commercial Credits.

Whitaker, A. C.—Foreign Exchange.

Langston, L. H.—Practical Bank Operation, Chapters XIV-XVI.

Questions and Problems on Chapter XIX.

1. Explain the steps in financing a shipment of olive oil from Italy to New York by: (1) a sterling letter of credit; (2) a dollar letter of credit. In each case make clear:
 - a. When the exporter of the oil gets his money.
 - b. When the importer of the oil pays for it.
 - c. Who really makes the advance.
 - d. Who bears the risk of exchange.
 - e. What banks profit.
- ✓ 2. In what ways is selling under a letter of credit superior to selling on open account?
3. Suppose the shipment of olive oil mentioned in question 1 should not be up to grade. Would the draft issued under the letter of credit be paid?
- ✗ 4. A maker of machine tools in Cincinnati, Ohio, wishes to sell his product in France. Explain the various ways the exports could be financed.
- ✓ 5. List and explain the documents used with the drafts.
6. Indicate what would happen if the one who is to receive the goods should fail before their arrival; if the accepting bank should fail.
7. Outline the present sources of credit information. Indicate the possible ways of improving them.

CHAPTER XX.

CATTLE LOAN AND AUTOMOBILE FINANCING COMPANIES.

Cattle loan and automobile financing companies will be discussed together because they represent a type of banking which specializes in security of a particular kind.

Cattle Loan Companies.

Loans to cattle-raisers must necessarily be for a longer period than the ordinary bank wishes to handle, and the security is of such a nature that it might easily disappear.

The two essential functions of the cattle loan company are to act as an intermediary in placing the loans, and to perfect an organization which can look after the security.

Granting the honesty of the borrower, the loan is very attractive, since the value of the security is constantly increasing. That is, as the proceeds of the loan are fed to the cattle, they constantly increase in value.

The money comes from the banks and the individuals who buy the paper from the cattle loan companies.

Automobile Financing Companies.

Special companies have developed to meet the need for credit to enable:

1. Dealers to buy from the manufacturers.
2. Purchasers to get the automobiles from the dealers.

Security in wholesale dealing is maintained by:

1. A warehouse receipt.
2. A trust receipt, if the dealer is permitted to have the car on his floor.

Security in retail dealing is maintained by:

1. A conditional sale contract, in which the title does not pass until the payments have been made.

2. A chattel mortgage, which is canceled when the payments are made.
3. A lease, calling for rental payments over a certain period and then the transfer of the title after a final payment.

Sources of funds of the finance companies are:

1. Capital subscriptions.
2. Borrowings from the banks.
3. Sales of notes.
4. Sales of collateral trust certificates based on the pledge of automobile paper.

Materials on Chapter XX.**Cattle Loan Companies.**

*From the Federal Reserve Bulletin, vol. 8, pp. 1171-1176
(October, 1922).*

The cattle industry has certain financial problems peculiar to itself and particular agencies have developed for dealing with those problems. Among these agencies are the cattle loan companies. The methods of financing used by the cattle loan company furnish an interesting illustration of how particular credit devices are developed to meet the special needs of an industry.

Financing problems in the cattle industry arose with the opening and rapid development of the territory west of the Mississippi. Both the industry itself and the financing methods employed were chaotic. The cattle were "longhorns," wild and inferior; the ranches were unfenced and "rustling" was frequent; heavy losses occurred due to insufficient water in summer and lack of feed in winter. Little discrimination was exercised in making loans. Finally the ranges became overstocked, and for several years after 1895 cattle raisers' losses were such as to render them unable to repay their loans. Many commission houses which had advanced funds failed and cattle paper became very unpopular. Since about 1900 conditions have changed. As one writer has said:

While pasture lands have decreased to a pitiful fraction of their former size, the transition has brought system and stability to the cattle industry. The ranches are now practically all fenced, the cattle are an improved type, disease is well controlled, and "rustling" is over. Water is supplied by engines or artesian wells, and adequate feed is stored for the winter. Skilled executives trained in approved business methods administer the affairs of the modern ranch. Cattle raising has become a specialized industry.

With this change in the character of the industry has come a change in financing methods and agencies.

The live-stock industry is now financed by three groups of organizations: Cattle loan companies, live-stock commission companies, and banks which lend money on live stock. The commission companies limit their loans for the most part to feeder loans [which are defined on page 734], and then only with the object of increasing their commission business. Banks make all classes of loans, but the legal restrictions on the amount which they may loan to one individual greatly curtails

NOTE.—This article is based in large part upon a study of Mr. Victor A. Newman, prepared in satisfaction of the senior research requirements of the Wharton School of Finance and Commerce, of the University of Pennsylvania. This material the Division of Analysis and Research supplemented by data kindly supplied by leading bankers and others associated with the industry in the principal live-stock centers.

their advances. The banks, whose capital and surplus is such that a 10 per cent maximum to one borrower would not prove a handicap, are located in distant larger centers, and so are not in a position to make the necessary investigation to protect themselves against loss. They therefore buy cattle paper rather than lend in the first instance on cattle. An organization possessing facilities for local supervision of loans is necessary. Moreover, such an organization must possess sufficient resources to enable it to finance a considerable volume of business. The cattle loan company, not subject to legal loan restrictions and obtaining its funds through resale of the loan it makes, fills this place. Some companies are organized independently, but, as a general rule, especially in the case of the larger ones, they are affiliated with some large national bank in a live-stock center. Stockholders, directors, officers, and headquarters are usually the same. In such cases the cattle loan company carries on those portions of the business which it would be extremely difficult, if not impossible, for a bank to handle.

In 1918-19, when cattle loan companies were carrying the largest amount of loans on record, the volume handled by the individual company ranged from \$500,000, in the case of the smaller companies situated at packing house centers, to approximately \$15,000,000 in the case of one or two companies. Since that time all companies have greatly reduced their loans—some of them as much as 50 per cent or more. This decrease has been due to the difficulty in placing paper as a result of general financial conditions; the realization by certain companies that their loans had been too large in comparison to their capital investment; and to the smaller amounts involved because of the decline in live-stock prices. In this connection it is interesting to note that some authorities believe a well-managed, conservative, cattle loan company can lend 10 to 20 times its capital and surplus. The larger companies, nevertheless, have felt that their loans should not greatly exceed 10 times their net worth, but in some cases, especially of the smaller companies, a much larger ratio has been lent. The average company, it has been said, places \$4,000,000 to \$5,000,000 of loans a year.

The capital and surplus of the individual company ranges from \$25,000 to \$1,000,000. The independent companies, it is generally stated, are smaller than the affiliated companies, although there are a few independent companies throughout the country that are as large as are the affiliated companies. The best companies are incorporated.

By far the greater part of the companies are located in the principal packing centers where the live-stock business is concentrated. Stockmen naturally seek funds at such points, while companies located there can inspect purchased cattle as well as watch the marketing of stock. Some

other large companies are located on the Pacific coast and in New Mexico. Very few have ranches.

The territory covered by the individual company depends upon the size of the company and the policy it pursues. Certain companies are willing to make loans at a greater distance from the head office than are others. In general, the territory naturally tributary to the most important centers is as follows:

Chicago.—The Corn Belt and the Northwest as far as western Idaho.

Kansas City.—Kansas, Oklahoma, Texas, and parts of New Mexico and Colorado.

East St. Louis.—Southern Illinois, Missouri, Oklahoma, and Texas.

St. Paul.—The Northwest as far as Montana.

Omaha.—Nebraska, South Dakota, Wyoming, Montana, and part of Iowa.

St. Joseph.—Kansas, Texas, and eastern Colorado.

Sioux City.—South Dakota and parts of Iowa, Nebraska, Minnesota, and Wyoming.

Oklahoma City.—Oklahoma, Texas, and New Mexico.

Denver.—Colorado and part of Wyoming.

El Paso.—Parts of Texas, New Mexico, and Arizona.

Salt Lake City.—Utah and Idaho.

Los Angeles.—California and part of Arizona.

Portland.—Washington, Oregon, Idaho, and parts of California, Utah, Nevada, to as far east as Nebraska and South Dakota.

Types of loans.—Loans are made on cattle and to a lesser extent on sheep. The present discussion will consider chiefly cattle loans. These may be divided into feeder loans, stocker loans, and dairy loans. Feeder loans have been defined as "loans made on beef steers which are ready to go into the last stage of feeding prior to their sale as finished beef." That is to say, funds are advanced for the purchase of stock to be fattened on the feed which the borrower already has or which he will buy out of his own funds. Stocker loans may be defined as loans on all cattle other than those going into the last stages of feeding or those used for dairy purposes. These loans are further subdivided into those on breeding cattle, those on young steers or heifers which will not be ready for the market for a year or more, and so-called "summer loans." Advances are not made ordinarily on registered breeding herds, because of their high value and the attendant great risk. Summer loans are made only in the West to enable the borrower to buy cattle for grazing during the summer. The rancher is able to graze more stock than he can feed in the winter, and it is expected that in the fall he will sell all those which he cannot feed. The cattle increase in weight, and

therefore in value, almost as rapidly on grass as in the feed lot. Dairy loans form a negligible part of the business of cattle loan companies, as they are dissimilar in many ways from the ordinary types of cattle loans. They run for relatively long periods, are usually payable in monthly installments from the proceeds of sale of butter fat, and are usually cared for by local banks.

Feeder loans are usually considered as furnishing the most desirable type of paper. They are ordinarily for a shorter period, and the cattle are at all times more marketable and are not subject to the same vicissitudes of weather, disease and accident as are stockers. Some authorities feel that such loans should not be made by cattle loan companies, but should be taken care of by commercial banks. Certain companies, however, do take a large amount of this paper, and, at the same time, exclude a great many stocker loans by avoiding summer and open-range loans, because of the danger arising from the difficulty of making the careful and continuous check-ups which are necessary in order to keep losses at a minimum. On the whole, however, the types of loans handled by any one company depend upon the territory which it covers. The majority of feeder loans are made by companies located in or near the Corn Belt—at Chicago, East St. Louis, Omaha, and Kansas City—as well as in the extreme western cattle country tributary to Los Angeles and Portland. Many of these companies, however, have more stocker than feeder loans; while stocker loans are easily in the majority among the cattle loan companies as a whole.

Placing of loans.—The companies make their loans in one of three ways—through country banks, through commission companies, or direct to the cattlemen. Many large loans come direct, but probably as many of the smaller loans are made with a local bank as intermediary. The percentage of the total loans that is made through commission companies ranges up to 15 per cent, but the latter figure may be exceeded in the case of companies actively associated with commission firms. Difference of opinion, however, exists as to the merit of such loans. Some observers hold that commission firms are at times not so careful in lending as they should be, because such loans are granted in order to increase the volume of their commission business. They are, however, in close personal touch with their borrowers, and it is said this is a strong element of safety in loans originating through them. Their loan procedure is very similar to that of the cattle loan companies, although the margin required is smaller in some cases. The commission firm assumes liability for payment by indorsing the paper. The cattle loan companies also indorse the paper.

Several methods are followed in placing loans through country banks.

Loans too large for the country bank are made direct to the cattleman, and the company merely pays the country bank a commission for negotiating the loan. In practically all other cases the paper is indorsed either by the country bank or by its officers or directors. The latter type of indorsement is often the most valuable, and at the same time keeps down the amount of borrowings which the bank must show on its books. Practically all companies check the credit standing of the borrower, irrespective of whether the loan is made through a correspondent or direct. Some companies feel that "the country banker will not make the borrower come to time," but other companies desire some one on the ground to look after their interests, and hence prefer to make loans through correspondents.

Credit work.—As is the case with other classes of loans, the importance of doing business with the right sort of men is to be emphasized. It has been said, "The brand on the man is worth more than the brand on the cattle." Information is obtained through four forms—application, financial statement, inquiry, and inspector's report. The application and financial statement are often consolidated. When the application is separate, it furnishes personal data as to the applicant, purpose of loan, security, and sometimes other information as to his business practices. This results in considerable duplication of data, particularly in the case of the security, real estate, feed, and range. Such questions, however, are often omitted from the application when a consolidated form is used. A special "brand sheet" accompanies either the application or the financial statement if the data are not included elsewhere. This gives in both illustrative and descriptive form the holding brand on the cattle, as well as any other brands which may be on them.

In accordance with general credit practice, all the larger and most of the smaller companies verify the information given by the applicant through inquiries. These are addressed to bankers, merchants, and cattlemen, as well as to the county recorder or similar official, who, for a small fee, gives an abstract of the mortgages upon the applicant's property filed or recorded in his office. Efforts are made by the companies to establish relations with banks in the territory they cover, upon whom they can depend for information.

The cattle loan company, however, attaches the greatest importance to inspections. Every company has at least one regular inspector, although some depend upon local men to make a part of their inspections. The local inspector is either a cattleman or a country banker. The latter is usually employed only to inspect loans which have not been taken through his bank. Considerable difference of opinion exists as to the value of the local inspector's work. Some companies state that

they are not always as reliable as they might be. In most cases inspections are made before a loan is accepted, and at intervals of from three months to one year thereafter, varying with the company. Practically every company, however, makes it a practice to inspect each loan at least once a year (it will not run that length of time unless renewed at least once), and inspection may be made at any time in case question arises as to the safety of the loan.

The inspection includes several matters. First, a count is made of the cattle covered by the company's mortgage. Most companies require a tally by class, number, value, weight, and brands. The latter is especially important, for the brand is the only means the company has of identifying its security. Further detailed information is required as to feed, range, and water, the general condition and appearance of the ranch or farm, and other data designed to verify that furnished by the applicant. Suggestions are also requested as to changes in the handling of the security. If cattle are purchased by the borrower in the center at which the company is located, the final inspection is easily made, and takes place at the same time as the purchase. If they are purchased elsewhere, an inspector is sent to the borrower's farm, and when they are delivered he inspects them to be sure they are the same cattle as he inspected previously.

Conditions of the loan.—One of the most important and most common conditions which must be met before a cattle loan company will make a loan is that the applicant shall be borrowing only from it. Confusion would be endless if one company held a mortgage on 200 steers and another a mortgage on 100 steers belonging to the same owner. Each company could only identify its security if the brands were different, and this is, in fact, required before any company will loan to an applicant who has already borrowed with cattle as security. Furthermore, if an occasion arises which compels one company to furnish expense money, a dispute is bound to arise as to which company should furnish the money. Large buyers of cattle paper in many instances will not take paper where the borrower is indebted to more than one company.

The company also often specifies that the borrower shall own his ranch. The reasons for this are that the rental of pasture may prove a burden for the cattleman, and that when the company lends to the landowner it may look to a first or second mortgage on the ranch as something to fall back on in case the loan becomes doubtful. Nevertheless, most companies will loan to renters under certain conditions, such as a long lease at a rental believed reasonable. In most cases, however, the deciding factor is the financial statement of the borrower and the

size of his net worth, especially in connection with feeder loans. His proven honesty and ability as a "cowman" are also large factors.

Collateral.—In addition to the signature of a second party to the note, the loan is secured by a chattel mortgage upon the cattle, and often upon "all the right, title, and interest of the mortgagor in and to the pasturage, feed pens, feed troughs, and water privileges used in feeding said live stock." Two features of the mortgage may be mentioned. First, it covers "all of said property and all accretions and additions and increase thereof." The inclusion of any increase is vital in the case of loans on breeding cattle, for in such cases the increase is relied upon to provide an additional margin of safety, as well as to provide funds to repay the loan when it is sold. Second, "the first party [the borrower] shall have no right to encumber said property in any manner whatsoever without the written permission of the holder of the note or notes hereinafter mentioned." In addition to giving the lender a preferred claim upon the property, it protects him against removal or sale of the security by the borrower and pocketing of the proceeds by the latter without paying off the loan. This is accomplished through a provision that any attempt to dispose of the cattle without the permission of the lender renders the note or notes immediately due and payable.

Further, if the cattle loan company "shall deem itself insecure at any time" it may take possession of the cattle given as security, and occupy the premises "where said live stock, cattle, or chattels may be . . . and may use and occupy said premises and pasturage, feed pens, feed troughs, and water privileges of said first party for the purpose of feeding or caring for said live stock, cattle, and chattels." This provision is necessary since unwise handling of cattle may result in a heavy loss in a short time. Finally, the mortgage gives the holder the right to call for more security, to move the cattle with or without the consent of the mortgagor into another location which is more favorable, or even to take possession of the cattle and ship them to market if necessary to protect the mortgagee's interests. In case of sale each owner is in turn responsible to the holder of the properly recorded mortgage for the amount of the note thus secured.

Co-operation with cattle raisers' associations.—In order to guard against disposal of the cattle without their knowledge, practically all companies, except those operating in the northern ranges, are members of a cattle raisers' association. Many companies also urge their borrowers to become members. These associations follow the movement of certain brands to market and notify the company which has loaned on cattle bearing that brand. They also employ brand inspectors outside of

the markets. In this way they serve to stop theft and fraud, as well as to assist in picking up "strays." One large cattle loan company obtains similar results by furnishing large commission companies, operating outside the immediate territory of the former, with a description of the brands on cattle which may possibly be sold through the markets of the commission companies.

Use of bill-of-sale drafts.—A further check upon the borrower is obtained by using a draft with bill of sale attached, in order to place the proceeds of the loan at the disposal of the borrower. The borrower buying cattle pays the seller with a draft on the cattle loan company. The reverse side of the draft contains a bill of sale, by means of which the seller certifies to the sale of the cattle to the borrower, and a blank assignment whereby the borrower assigns his interest in the cattle to the cattle loan company.

While the use of a bill-of-sale draft is customary, other methods are sometimes employed. The borrower may simply be credited with the amount of the loan in the bank with which the company is affiliated. On the other hand, when the local bank has handled the loan directly, it may advance the money for the purchase of cattle, and be repaid by the company after the note and mortgage have been drawn up. In case the cattle have been bought at one of the larger markets, the company may also make payment directly to the commission company which has made the purchase for the borrower.

Margins.—Margins required vary greatly, both between companies and between loans made by the same company. In general, the advance per head is determined by the financial responsibility of the borrower, the amount of feed he has on hand, the kind and grade of cattle, and the method of handling them. In the case of feeder loans, the company at times may require no margin whatsoever if the borrower has plenty of feed and is financially responsible. In the case of these loans, moreover, the cattle which are taken as security increase in weight from $1\frac{1}{2}$ to 2 pounds per day. Further, the value of meat is higher in the case of fat stock. Accordingly, as the loan continues there is gradually built up a margin, which at the end of the loan may well amount to 20 per cent. In some cases a margin ranging from 10 to 50 per cent, according to the particular case in question, is required at the time the advance is made. Minimum margins required on feeder loans by different companies range up to 30 per cent.

The margin on stocker loans has always been higher than that on feeder loans. In many cases it has also been higher on stocker loans, with breeding stock as security, than on loans made on young steers. This is due to the fact that the feeder loan has always been considered

more liquid, because the stock is in better condition for market at all times and because the increase in the value of steers on full feed is more rapid than the increase in the value of young steers not yet ready for feeding or of breeding stock which must depend upon an increase in number for enlargement in value. Margins required on stocker loans, therefore, vary from 10 per cent to 60 per cent, the minimum requirements of the several companies being from 10 per cent to 40 per cent. As a result of the abrupt decrease in the value of cattle and the consequent necessity of carrying cattlemen, new loans are, in many instances, bearing a higher margin than before.

Maturities.—The period for which a cattle loan runs varies with the type of the loan. Feeder loans usually run from two to four months, with occasional loans up to six months, depending upon how nearly ready for market the cattle are. Stocker loans, however, from their very nature, run usually for six months. This is the maximum time for which cattle loan companies will make advances, but they may, at times, make loans with the understanding that they will be renewed, provided all conditions remain satisfactory. Renewals may occur from one to three or four times. The length of "steer loans" depends upon the period necessary to prepare the stock for market or for the feeder, but is usually less than for loans on breeding stock, which are paid off by the sale of the increase. The latter requires some time, ordinarily 18 months. The cattlemen may be carried from year to year, although the security may change, when the loan is renewed, through the sale of some cattle and the purchase of others.

Feeder loans are usually not renewed, for they are supposed to be made upon cattle almost ready for slaughter. During recent years, however, a considerable number of loans were renewed in the hope that prices of live stock might advance and thus enable the loan to be liquidated. Stocker loans, except where the stock is ready to be fed or marketed, usually require renewal. Many, however, will gradually be reduced, especially in the case of breeding loans. Renewals on stocker loans have also increased greatly since the fall in prices. The normal percentages of renewals of such companies, ranging from 50 per cent to 75 per cent, have increased to 75 per cent to 90 per cent.

Losses.—Under normal conditions, losses of cattle loan companies have been negligible. Only one company on which data were obtained had a loss of as much as 1 per cent per annum, and this was a comparatively new organization operating in a territory stricken by drought shortly after its entrance into the cattle-loan field. Other companies show annual losses of one-twenty-fifth to one-tenth of 1 per cent.

For about five years conditions have not been normal. In 1917-18

there was a severe drought in a large part of the cattle-raising region of the Southwest. The following winter (1918-19) was unusually severe in that locality. The Northwest experienced a bad drought during the summer of 1919, which was followed by a very cold and snowy winter. During 1920 and 1921 cattle prices fell to the level of 1913 and below.

The loss due to drought during this period was not so heavy, partly because the cattlemen themselves were in good financial condition and partly because measures could be taken to care for stock in drought-stricken regions. The blizzards increased the loss suffered by the cattlemen, although the loan companies did not suffer heavily. The loss occasioned by the break in prices, however, was too heavy to be borne by the stockmen. Many were ruined, and the cattle loan companies are now experiencing the heaviest losses in their history. In many cases they have had to carry borrowers in the hope of ultimate repayment, where collections could not be made under the prevailing conditions.

Companies operating in regions afflicted with droughts and blizzards put these first among normal causes of loss. Companies operating in regions where these phenomena are not frequent place incompetency first or else neglect by the owner of his stock. In no case does disease cause serious loss, as companies do not operate in tick-infested areas and have experienced no loss from the hoof-and-mouth disease. In general, few losses can be assigned to fraud on the part of the borrower. Some of the companies which sprang up during the period of prosperity encouraged speculation by slackening their requirements during the period when money was easy. In addition to failing to demand proper margins, they took less than the usual amount of care in selecting borrowers.

Handling of doubtful loans.—There are two methods of procedure in handling doubtful loans. In case of fraud the security is disposed of without consideration of the debtor. If the loan becomes doubtful, however, because of drought or a drop in prices, the company usually endeavors to protect its customers. This is done by directing to some extent the handling of the cattle and by frequent inspection of them. The frequency of inspection will depend upon the particular conditions in each case; it being stated they are made more often in the instance of drought than in the case of a drop in prices. In any event, the loan company attempts to secure additional protection through a mortgage on real estate, other stock, indorsements, or any form which may present itself. The period for which the debtor will be carried depends upon the conditions of each individual case.

Sale of paper.—Whether the buyers of the paper are chiefly country banks or other financial institutions depends largely upon the location of the cattle loan company. Thus, companies located in cities such as

El Paso, Oklahoma City, or St. Joseph sell from 90 per cent to 100 per cent of their paper to eastern banks, whereas a large portion of the paper of companies in cities such as Chicago, St. Louis, Sioux City, St. Paul, or Kansas City is sold locally. Except in the last-named city, nevertheless, the majority goes to country banks, as distinct from private investors, although the latter do take a small percentage, in one case estimated as high as 15 per cent. Recently some savings banks in Chicago have been buying cattle paper, and there are also a few instances of paper being placed with commercial paper houses, but it is not believed this practice has been followed to an appreciable extent.

Cattle loan companies often arrange for lines of credit from banks which gives them a potential outlet, at least, for their paper. The line will not under ordinary circumstances ever be in excess of five times the average balance maintained by the cattle loan company. Among the advantages claimed for the affiliated as against the independent company is the fact that the bank can absorb its surplus of paper at times when the smaller banks, which purchase seasonally, are not in the market. The company usually makes it a practice to keep an amount of paper on hand equal to its combined capital and surplus.

Any given loan on cattle may be evidenced by one note, or by several, in denominations such as \$1,000, \$5,000, and \$10,000, which are placed with different purchasers. The loan company holds the mortgage as trustee in either event, and the buyer of the paper looks to it for payment, the majority of the companies indorsing all the paper they sell. The investor who takes a complete loan may receive a duplicate copy of the mortgage, while the purchaser of a small note receives a "certified trust receipt of chattel mortgage."

Rarely does the interest charge of cattle loan companies go below 6 per cent and in few instances below 7 per cent, while 8 per cent is not uncommon. Accordingly, the profits of the company are decided to a great extent by the money rate in the chief financial centers where the larger proportion of the paper is sold. That is to say, as the rates in these centers advance, the margin of profit for the cattle loan company decreases. Under normal conditions the margin averages about 2 per cent gross and the expenses range from 1 per cent to $1\frac{1}{2}$ per cent.

Conclusion.—It may be worth while here to indicate the place of the cattle loan company in the present financial organization of the country. As an agency for testing credit and for supplying funds, the cattle loan company performs a function that may be distinguished from other organizations engaged in live-stock financing. Through its facilities for local supervision of loans it keeps a close acquaintance with the condition of the borrower and of the security. Its loans are less

specialized in character than those of the live-stock commission houses, and because of freedom from legal restrictions may be made in larger amounts to a single borrower than may the loans of a country bank. Finally, the cattle loan company by resale of the paper it buys distributes the loans among many lenders and draws additional funds into the live-stock industry.

The Automobile Finance Company.

From an unpublished thesis by Wallace McCook Cunningham.

The Rapid Growth of the Automobile Industry and Its Relation to the Automobile Finance Company.

The extremely rapid growth of the automobile business gave the manufacturer a task in financing his increasing production that was constantly pressing—a task rendered all the more difficult by the fact that many bankers were for a long time inclined to look upon the business as a more or less mushroom growth quite likely to encounter a decline or collapse like that which had already overtaken the bicycle industry. Many who were somewhat more favorably inclined, looked upon the automobile as an article of luxury, with the potential market at any given time closely approaching the point of saturation.

In view of this situation, the manufacturer was not as a rule in a position to finance the distribution of his products, and because of the fact that he was enjoying an almost continuous seller's market, it was in no wise incumbent upon him to do so. Moreover, for the first few years of the extensive development of the industry, the cars sold were, on the average, relatively high-priced and were viewed as articles of luxury, the payment for which upon installment contracts would be considered in the same light as would the payment for costly furs or of diamonds upon similar contracts. In brief, the buyer was a person who usually expected to pay cash and who generally did so, and the seller's market put the manufacturer in a strategic position to demand cash of the dealer and put the dealer in a similar strategic position to demand cash of the purchaser. The dealer, as a rule, could sell for cash as many cars as he could get the manufacturer to allot to him, and frequently demanded part payment with the order, well in advance of the promised but not guaranteed date of delivery.

With the introduction of the medium-priced automobiles and of the so-called cheap automobiles came the great demand by the salaried man and the wage earner for cars—in part for pleasure and social prestige and in part, and to an increasing extent, for utility. In most cases, such cars would serve both purposes.

It is doubtful whether this extension of the automobile market could have been as rapid if retail sales had been made only to purchasers who could pay cash. The rapid growth in the number and monetary volume of deferred-payment sales, financed through automobile finance corporations since their first credit operations in 1916, coincides with the phenomenal growth in sales during and subsequent to that year, a growth effecting to a noteworthy extent the proportion of low-priced cars which form the basis of most of the financing of the automobile finance companies. The amount so financed in 1920 has been estimated at \$600,000,000, or a little more than 25 per cent of the total wholesale valuation of automotive production. Statistical data¹ compiled by General Motors dealers, representing the largest and most powerful group in the motor world to-day, show that 42.6 per cent of all passenger cars and 54.9 per cent of all trucks sold by General Motors dealers in 1919 were bought upon the deferred-payment plan. Estimates² based on these statistics would indicate that approximately 70 per cent of all motor cars are bought on credit. This increase in the estimated percentage figures is due to two reasons. First, the General Motors Acceptance Corporation's percentages are partially based upon the sales of the Buick and Cadillac cars, both of which, during 1919, commanded not only a cash sale, but often a cash premium to secure delivery. Secondly, the General Motors Acceptance Corporation's percentage figures do not take into consideration the large sales of such low-priced cars as the Ford, Dodge, and Overland.

The main contribution which the automobile finance corporation has made to the automotive industry has been the deferred-payment plan of retail sales. Under this plan, prospective motor-car purchasers who cannot meet the cash terms of the automobile trade are able to buy cars on the terms of part cash, part credit. This permits automobile purchasers to enjoy the added pleasure and efficiency of motorized transportation during the period in which they are paying for their car out of their monthly earnings. This plan of purchase is particularly attractive to farmers, doctors, salesmen, real estate and insurance men, contractors, and others to whom the automobile is a means of greater efficiency and increased income.

Such a method of purchase is of even greater advantage to purchasers of motor trucks for commercial trucking and hauling. It permits carriers and contractors to purchase necessary motorized transportation equipment without tying up large sums of working capital. This method of financing commercial transportation is rapidly growing in favor,

¹ Printers Ink, May 17, 1921.

² E. S. Maddock, President of Continental Guaranty Corporation.

especially as the business of trucking and hauling tends to become a specialized industry in itself.

Many automobile finance corporations finance the dealer as well as the retail purchaser. The stocking of a proper inventory of cars, in order to be able to make immediate deliveries, requires a considerable outlay of capital on the part of the dealer. Sometimes this inventory of cars is abnormally large owing to seasonal and other fluctuations in demand. This situation is always present in the winter season. The necessary capital has heretofore been supplied either by the dealer himself or else by local banks in the community where the dealer operates. The rapid growth of the motor-car industry, however, has in many cases so increased the capital needs of automobile distributors that new sources of capital have become necessary. Many automobile finance corporations have undertaken to supply this demand of the distributor for financial accommodation.

The economic origin of the finance corporation is to be found, therefore, in the increased demand for credit which was in part both a cause and an effect of the rapid expansion of the automotive industry during the years 1915-1920. . . .

The financing of the automobile dealer's stock in trade.—The work of the automobile finance company divides itself into two parts: first, the financing of the dealer's stock in trade, often called wholesale financing, and, second, the financing of the installment contracts of the purchaser, usually called retail financing.

There are two distinct methods used by the finance companies in wholesale financing operations: the indorsement or liability-agreement method and the non-indorsement method. The former is the prevailing method among the larger companies, which usually operate on a national scale. It is used by the General Motors Acceptance Corporation, Continental Guaranty Corporation, the Bankers' Commercial Security Company, Inc., and Hare & Chase, Inc. The latter or non-indorsement method is followed by most of the smaller or local finance companies, though the Meyer-Kiser of Indianapolis and the Commercial Investment Trust of New York and some other large national companies operate under this method. Ford automobile paper is always sold under the non-indorsed method, as Ford has consistently refused either to indorse for an automobile finance company or to form one himself. . . .

There are two different methods which a dealer may employ in "stocking" an inventory of cars. He can purchase cars and store them in a public licensed warehouse pending their sale, or he can store them in his own showrooms, garage, or private warehouse. If a dealer chooses to use the first, or warehouse, method, all credit obligations arising out

of the stocking said cars must be secured by properly issued warehouse receipts. If the dealer adopts the second, or "floor plan" method, all credit obligations arising out of said "stocking" of cars must be secured by a "trust receipt," given by the dealer to the finance corporation. . . .

There is a distinct advantage to the dealer who uses the "floor plan" and "trust receipt" method of stocking cars because it permits him to have cars in his possession for display purposes. There is a disadvantage, however, in this method to the finance company as against innocent third parties for value. Test cases are now being conducted in different States to determine the exact legal status of the Trust Receipt agreement. . . .

Even though approximately 50 per cent of the sales of the average automobile dealers are cash sales, it is evident that he could not himself finance the time purchases of his customers, since automobiles are costly merchandise. The manufacturer, because of the exceedingly rapid expansion of his industry, has as yet been unable to accumulate such a surplus that he could wait ten months for his money, and so the plan of financing the purchase of automobiles on credit through the discounting of acceptances and the sale of notes to bankers and investors has developed. The result of such retail financing by the automobile finance company is, first, the development of a method by which a purchaser may be able to purchase automobiles or trucks by deferred payments and, second, the ability of a dealer to consummate sales on what amount to practically a cash basis with, however, the liability as indorser.

In a circular to dealers, a leading company states that the advantages to the dealer are:

1. One hundred per cent cash in every credit sale.
2. All of your profit immediately.
3. Insurance protection of your interests.
4. Expert credit advice.
5. Free collection service.
6. Free use of your own capital.
7. Prompt remittances on paper sent us.
8. Increased sales.
9. All necessary forms at no cost.

Most companies require that the credit obligations given by the purchaser be indorsed by the dealer. The dealer thus becomes contingently liable for all notes taken by him in payment and the obligation becomes double-named paper.

As in the case of wholesale financing, the finance companies require a detailed credit statement to be rendered by every prospective time-payment purchaser. . . .

The down payment of cash formerly required ran anywhere from

25 to 60 per cent, but is now always well above 30 per cent in the case of better companies and is usually 50 per cent or over except in cases where the credit risk is better than the average either because of the credit standing of the dealer or of the purchaser or of both.

The period of deferred payment never extends beyond sixteen months and seldom is less than six months. Six, eight, ten, and twelve months are the usual periods upon which the partial payments are calculated. Periods of seven and nine months are found in certain plans of payment used only in rural districts.

Most plans call for regular monthly payments equal to a month's proportion of the total amount of credit advanced. For example, if the deferred payment was based on the ten-months' plan, then one-tenth of the total amount of credit advanced would be due each month. If the sale was based on an eight-months' payment plan, then one-eighth of the total credit obligation would be due each month.

Documents Used in Financing the Dealer.

GMAC Form NY-3 (New York)

**WAREHOUSE PLAN. BILL OF LADING SHIPMENTS FROM DIRECT DEALERS AND DISTRIBUTORS
to SUB-DEALERS.**

This form is to be used only in financing Bill of Lading shipments by Direct Dealers and Distributors to Sub-Dealers, when cars are to be stored in approved warehouse, in the following cases:

1. Direct Shipments: Direct Dealer or Distributor to Sub-Dealer.
2. Short Cut Shipments: Manufacturer to Sub-Dealer for account of Direct Dealer or Distributor.

GENERAL MOTORS ACCEPTANCE CORPORATION

1737 Broadway
New York, N. Y.

NEW YORK

INSTRUCTIONS TO DEALER

FORM NY-3A

To..... 19.....

(State)

(City)

Address.....

The undersigned has shipped the Motor Vehicles covered by attached invoice to..... Warehouse

located at.....

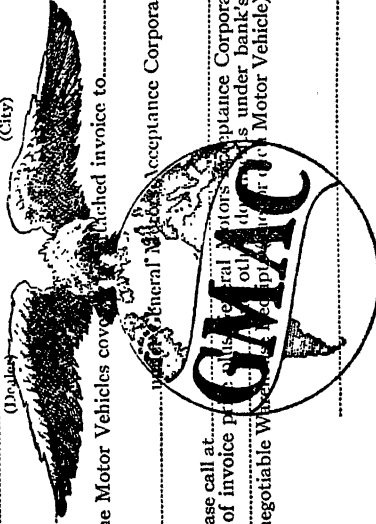
(City in which located)

General Motors Acceptance Corporation financing plan.

When Motor Vehicles arrive please call at..... Bank
 and pay Sight Draft on you for 10% of invoice price plus General Motors Acceptance Corporation charge (and extras if so desired),
 execute Trade Acceptance for \$..... is under bank's instructions and arrange with above
 Public Licensed Warehouse to deliver negotiable Warehouse Receipt for Motor Vehicle) to bank in exchange for Bill of Lading.

(Shipper)

(Address)



INSTRUCTIONS TO BANK

FORM NY-3B

To.....19.....
 (City) (State)

Bank.....
 Address.....

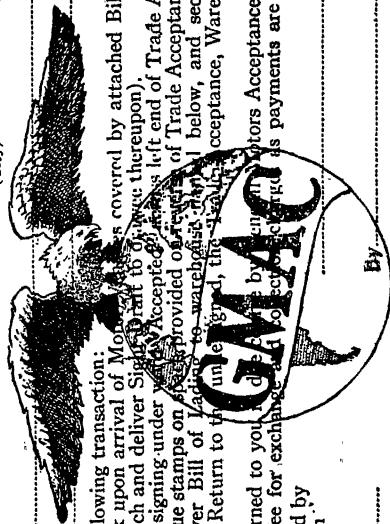
Please act for the undersigned in the following transaction:
 Notify drawee to call at your bank upon arrival of Motor Vehicle as covered by attached Bill of Lading, and:

1. Pay Sight Draft (detach and deliver Sight Draft to General Motors thereupon).
2. Accept by dating and signing under warehouse Receipts as left end of Trade Acceptance.
3. Place necessary revenue stamps on Receipts provided on reverse of Trade Acceptance.

Upon execution as above, deliver Bill of Lading to warehouse (shown below), and secure in exchange therefor Warehouse Receipts (one for each Motor Vehicle). Return to the undersigned, the Warehouse Receipts, and proceeds of Sight Draft.

They will allow you the usual fee for exchange and processing charges as payments are made.

Following Warehouse has been approved by
 General Motors Acceptance Corporation



(Warehouse)

(Address)

(Official Title)

(Address)

(Shipper)

FORM NY-3C

19

Payable at

IRVING NATIONAL BANK, TRUST DIVISION

NEW YORK, N. Y.

ACCEPTED

By _____

(Official Title)

To _____

(Dealer)

At _____

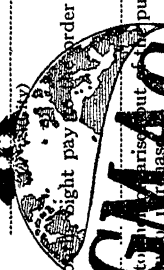
Money will be paid by order of ourselves at New York, N. Y.

(State)

19

DOLLARS

The obligation of the Acceptance is in full payment of the purchase of goods from the drawer, maturity being in conformity with original invoice.



IDENTIFICATION NO. _____

Always quote this number when reporting

MATERIALS OF BANKING

Pay to the Order of
General Motors
Acceptance Corporation
New York, N. Y.

.....
(Shipper)

By.....
(Official Title)

Address.....
(No.) (Street)

.....
(City) (State)

REVERSE SIDE OF TRADE ACCEPTANCE.

Dealer affix
Revenue Stamps
here, 2c for each
\$100 or portion
thereof.

SIGHT DRAFT

FORM NY-3D

\$ 19.....
(City) (State)

AT SIGHT PAY TO THE ORDER OF OURSELVES

..... DOLLARS

Value received and charge to

To..... (Dealer) (Shipper)

By..... (Address) (Official Title)

GMAC 100-10M Seta-1-21
Approved 12-27-21

Documents Used in Financing the Purchaser.

Instructions: ORIGINAL—To be filed or recorded according to State Law.

CHATTEL MORTGAGE—

For use in Colorado, Illinois, Michigan, Missouri, Ohio.

KNOW ALL MEN BY THESE PRESENTS, that.....

(Purchaser's Name)

.....hereafter called the mortgagor has this day purchased from
of.....

of.....

(Seller's Name)

hereafter called the mortgagee, the following property, complete with standard attachments and equipment, delivery and acceptance of which is hereby acknowledged by Mortgagor, viz.:

MAKE Trade	Year Model	Type of Body If Truck state tonnage	Model Letter or Number	Manufacturer's Serial No.	Motor No.	State License No.	New or used
ONE							

For the total Time Price of (\$).....
 Payable as follows: Cash on or before delivery \$.....
 \$..... One month after date
 \$..... Two months after date
 \$..... Three months after date
 \$..... Four months after date
 with interest thereon after maturity at the highest lawful rate, which said indebtedness is hereby confessed and acknowledged.

Dollars.
 Balance of \$..... as follows:
 \$..... Five months after date Nine months after date
 \$..... Six months after date Ten months after date
 \$..... Seven months after date Eleven months after date
 \$..... Eight months after date Twelve months after date

1. For the purpose of securing payment of said purchase price the mortgagee does hereby grant, bargain, sell and mortgage unto said mortgagee the above described personal property to have and to hold the same unto said mortgagee, said mortgagee's personal representatives, successors and assigns forever.

2. Provided always that if said mortgagee shall well and truly pay or cause to be paid to mortgagee said sum above mentioned and all agreements herein shall have been fully performed by the mortgagee, then this instrument shall be void, otherwise to remain in full force and effect.

3. In the event mortgagee default on any of the above payments, or a proceeding in bankruptcy, receivership or insolvency be instituted against the mortgagee or his property, the full amount then remaining unpaid, shall, at the election of the mortgagee, become immediately due and payable.

4. Mortgagee shall give his promissory judgment note, of even date herewith as evidence, but not payment, of the amount payable hereunder. This note to contain a confession of judgment, provision for attorney's fees, a waiver of the issue and service of process, all benefits of valuation, appraisal and exemption laws, and all rights of appeal and a release of all errors.

5. The property is to remain in the possession of the said mortgagee as long as the conditions of this mortgage are fulfilled.

6. The negotiation or discounting of said note, or renewals or extensions thereof, the assignment of this mortgage, or the instituting of suit or procuring of judgment thereon, or the loss, injury or destruction of said property, shall not operate as payment, or in any manner release said mortgagee from his obligations hereunder, and the holder of said note shall be entitled to all rights of the mortgagee hereunder.

7. The term "property" whenever used in this mortgage shall include any equipment, attachments, accessories and repairs placed on said property by the mortgagor. No warranties have been made in reference to said property by the mortgagee to the mortgagor unless expressly written hereon at the date of execution of this instrument.

8. Mortgagor shall pay, and keep said property free and clear of any and all taxes, assessments, liens and encumbrances of any nature whatsoever, and shall not use the same improperly or for hire without the written consent of the mortgagee, and shall give immediate written notice to the mortgagee of any and all loss of, or damage to, said property; in default thereof the mortgagee shall have the right to take possession of the property and hold the same pending the maturity of the above obligation, all at the expense and risk of the mortgagor, which said expense mortgagor agrees to pay. The proceeds of any insurance paid by reason of any loss or injury to the property, or any return premium becoming due on the cancellation of any insurance policy on the property shall become subject to the terms hereof to be applied toward the repair and replacement of the property or pro tanto payment of the above obligation as the mortgagee may elect.

9. In the event of a default of the mortgagor in complying with the terms of payment hereof, the mortgagee may at his election, notice of which election is hereby expressly waived, foreclose this mortgage by action or otherwise and said mortgagee is hereby authorized to take immediate possession of said property, and for this purpose mortgagee may enter upon the premises where said property may be and remove the same; and the mortgagee may sell said property so retaken and all equity of redemption of the mortgagor therein, either at public or private sale without demand for performance, with or without notice to the mortgagor and with or without having such property at the place of sale, and upon such terms and in such manner as mortgagee may determine; and to that end may make such repairs as mortgagee deems necessary; and mortgagee shall have the right to bid at any public sale.

10. The mortgagee shall have the right to deduct from the proceeds of any sale the cost of foreclosing this mortgage and all expense incurred by the mortgagee in retaking, repairing and selling said property including a reasonable attorney's fee, and the balance thereof shall be applied to the amount due holder of said note and any surplus remaining shall be paid over to the mortgagor; and in case of a deficiency mortgagor covenants to pay the same forthwith with the highest legal rate of interest and the mortgagor does hereby confess judgment in the amount of said deficiency.

11. Mortgagee shall have the right to enforce any one or more remedies hereunder, either successively or concurrently, and such action shall not operate to estop or prevent the mortgagee from pursuing any other remedy which he may have hereunder, and any repossession or retaking of the property temporary or otherwise or sale of the property, pursuant to the terms hereof shall not operate to release the mortgagor until full payment has been made in cash

12. The mortgagor shall not transfer any interest in this mortgage or the property covered thereby, without the written consent of the mortgagee.

13. If the mortgagee shall at any time deem said mortgage, said property or said debt unsafe or insecure, the whole amount herein secured on said negotiable instrument remaining unpaid is by said mortgagor admitted to be due and payable and said mortgagee may at said mortgagee's option repossess said property as herein provided.

IN WITNESS WHEREOF the parties hereto have set their hands and affixed their seals to this agreement and to a duplicate and triplicate thereof, one of which was delivered to and retained by the mortgagor this..... day of..... 19....., at.....

WITNESSES:

..... (City) (State)
Do not sign here unless you have actually received the property described above, since by doing so you might place yourself in the position of being a party to a fraud.

..... (Mortgagor's Signature) (L.S.)

By.....

..... (Witness' Signature)

..... (Official Title)

..... (Mortgagor's Address)

..... (Mortgagee's Signature) (L.S.)

By.....

..... (Witness' Signature)

..... (Official Title)

..... (Mortgagee's Address)

NOTARY PUBLIC In states where acknowledgment or affidavit is necessary for filing or recording, Notary Public will insert necessary acknowledgment or affidavit on reverse hereof.

GMAC No. 100
Revised as of 4-22

PURCHASER'S STATEMENT—MOTOR VEHICLES

This form to be used when merchant desires G. M. A. C. Credit Department's opinion before closing transaction and/or when merchant wishes to retain copy of Purchaser's Statement.

To Dated at (City) (State) , 19
(Name of merchant on this line) and to General Motors Acceptance Corporation.

Make of Car.....	New <input type="checkbox"/> or Used <input type="checkbox"/>	Allowance, if any, for "trade in"
To be Insured for Fire and Theft <input type="checkbox"/>	Collision <input type="checkbox"/>	Amount of Note.....
Public Liability <input type="checkbox"/>	Prop. Damage <input type="checkbox"/>	Number of Months.....
Cash from Customer.....		Number of payments.....

Questions and Problems on Chapter XX.

1. A purchaser of a \$1,200 new car pays \$360 down and makes 12 monthly payments of \$74.80. What interest is he paying for the use of the money?
2. A purchaser of a \$1,200 used car pays \$480 down and makes 12 monthly payments of \$66. What interest is he paying for the use of the money?
3. Discuss the automobile as collateral from the standpoint of:
 - a. What it would bring at forced sale.
 - b. The desire of the purchaser to finish paying for it.
 - c. The addition to the earning power of the purchaser.
4. Discuss the possibilities for financing the sale of victrolas, radio outfits, heating plants, etc., by companies similar to the automobile finance company.
5. Why do not the New York banks lend direct to the cattle raisers?
6. Why do not the cattle raisers borrow from their local banks?
7. What advantages does the large cattle company have over the small one?
8. Explain the method of keeping track of the security used by the cattle loan company.
9. Discuss the possibility of using a similar plan to finance the planting of orchards, the draining of farms, and the purchase of implements.

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